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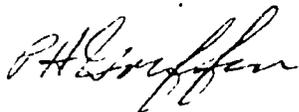
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AUDIT OF
MAHAWELI SECTOR SUPPORT LOAN
SRI LANKA
AUDIT REPORT NO. 5-383-85-4
AUGUST 29, 1985

memorandum

DATE: August 29, 1985

REPLY TO
ATTN OF: P.H. Griffin, RIG/A/K (A)



SUBJECT: Audit of Mahaweli Sector Support Loan
Audit Report No.5-383-85-4 dated August 29, 1985

TO: Mr. Frank D. Correl, Director
USAID/Sri Lanka

We are pleased to present the report on our review of the Mahaweli Sector Support Loan. Our objectives in making the audit were to review compliance with AID regulations and policies and with the terms of the Loan agreement. A further objective was to review program results.

The Sector Support Loan has provided important assistance for the downstream activities of the Mahaweli program, but has not provided all of the intended economic benefits. The initial motivation for the Loan was to generate non-inflationary local currency for domestic expenditures and to provide quick-disbursing balance of payments assistance. The Loan did not generate local currency for expenditure as proposed in the Program Assistance Approval Document, but instead reimbursed the Government of Sri Lanka through an unrestricted special letter of credit. This proved to be a very slow payment procedure. Also, the Government of Sri Lanka did not require the funds for downstream activities as rapidly as anticipated and thus, was slow to request reimbursement from the Loan. At December 31, 1984, the Government of Sri Lanka had drawn only \$27.2 million of the Loan funds.

Although the Loan was intended to provide only general budgetary assistance, the Mission has been monitoring expenditures in more detail than required. We recommended a change in monitoring procedures which the Mission has made and the recommendation is closed with the issuance of this report.

We discussed our findings and recommendations with you and members of your staff. Your comments and suggestions were included in the final draft. In view of your response to the draft report that enabled us to close the one recommendation in the report, no further action is required on your part.

AUDIT OF
MAHAWELI SECTOR SUPPORT LOAN
SRI LANKA

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EXECUTIVE SUMMARY

The Office of the Inspector General made an audit of the Mahaweli Sector Support Loan in Sri Lanka. The objectives of the audit were to review loan implementation for compliance with AID regulations, policies, and the terms of the loan agreement and to review program results. The audit was conducted in Colombo, Sri Lanka and covered loan activities for the period May 29, 1981 through December 31, 1984.

The \$50 million loan agreement was signed on May 29, 1981, and the program is to be completed by June 30, 1985. The purpose of the Loan was to assist the Government of Sri Lanka carry on the downstream activities of the Mahaweli program during a period of budget deficits. This assistance was intended to provide non-inflationary, general budgetary support and fast disbursing foreign exchange assistance that would also increase imports from the United States.

Although it has provided important support for the downstream activities of the Mahaweli program, the Loan has not provided the intended economic assistance. The GSL has claimed reimbursement for Loan funds at a much slower rate than was anticipated because funds were not required for the downstream activities as rapidly as had been assumed when the Loan was planned. Also, instead of generating local currency for expenditure as proposed in The Program Assistance Approval Document, the Loan reimburses the Government of Sri Lanka for expenditures through an unrestricted special letter of credit. This is a slow and cumbersome method of transferring funds. As a result, the Government of Sri Lanka has not received the Loan funds as rapidly as intended; at December 31, 1984 only \$27.2 million of the \$50 million Loan had been drawn.

The Loan has not encouraged increased imports from the United States. The Government of Sri Lanka has used completed procurement transactions to draw the funds from the letter of credit. These transactions were made with no reference to the Loan funds and would have taken place without the Sector Support Loan. The volume of trade with the United States is small, and since it has been difficult finding eligible procurement transaction, until recently funds have been drawn slowly from the letters of credit.

The principal motivation for the Loan was to provide fast disbursing economic assistance. When the Mission recognized that the Loan was not having the intended economic impact, action should have been taken to speed up the transfer of resources to the Government of Sri Lanka. Because of the June 30, 1985 termination of the Loan, however, we have made no recommendation.

The Loan was designed to provide only general budgetary assistance; it was not intended to fund the procurement of specific goods and services. In order to ensure that the AID reimbursements could not be associated with specific goods or services, a provision was added to the loan limiting AID's reimbursement for any period. In processing reimbursements, the Mission has been reviewing all claims in detail and disallowing items that were not considered appropriate for AID funding and also has been limiting the reimbursement. We recommended that the Mission treat future reimbursement as general budgetary support, as intended. The Mission made the recommended changes.

The report that evoked the response in Appendix 1 was the initial draft of this report. After discussions with Mission officials and reviewing their written comments, we revised the report. We believe that the report now reflects the Mission's concerns regarding the Loan's principal objective.

Office of the Inspector General

Office of the Inspector General

AUDIT OF
MAHAWELI SECTOR SUPPORT LOAN
SRI LANKA

PART 1 - INTRODUCTION

A. Background

The Mahaweli Sector Support Loan Program Assistance Approval Document (PAAD) authorized a \$50 million loan to the Government of Sri Lanka (GSL); \$13.8 million was obligated in FY 1981 and the balance in FY 1982 and FY 1983. The purpose of the program assistance loan was to assist the GSL to carry on essential downstream activities in the Mahaweli program during a time of budget deficits. Program assistance instead of project assistance was considered appropriate because Sri Lanka's development policies have a long record of commitment to improving the well-being of the rural poor. Its quality of life indicators - infant mortality, life expectancy, and literacy - are better than those of most developing countries with significantly larger incomes.

A new government took office in 1977 and began implementing reforms to overcome the economic stagnation that had set in under the prior administration. The reforms were based on an ambitious public investment program intended to create employment opportunities, to achieve self-sufficiency in basic food items, to diversify and increase exports, and to improve the economic and social infrastructure. Donors responded to this reform program with substantial amounts of external financing, and after three years the economy had begun to recover. The gross domestic product increase averaged 7.3 percent in 1978 and 1979, double the 1970-1977 rate, and employment levels were the highest ever.

In 1980, this program of economic reform was overtaken by a world-wide recession and increased import prices. The recession reduced Sri Lanka's export income when its requirements for imports were increasing and the cost of the imports was rising; oil prices more than doubled in 1980. The result was a budget deficit that reached 43 percent of government expenditures in 1979 and was estimated at 53 percent in 1980. Domestic borrowing financed 52 percent of the deficit in 1979 and about 51 percent in 1980. This borrowing increased the money supply and caused the inflation rate to reach 30 percent in 1980, giving rise to the danger of a vicious cycle in which deficits cause inflation that in turn cause larger deficits.

Because of the requirement for importing investment goods, the poor performance of exports, and the increase in the price of oil, the balance of payments also deteriorated. Although much of the investment for the public sector was financed by foreign assistance, foreign exchange reserves were seriously depleted, equalling only one week of imports at the end of 1980. In 1981, import growth was expected to decline and exports to rebound slightly, but a large foreign exchange deficit was still expected.

The GSL was faced with a difficult trade-off between reduced investment compromising economic and social development and budget deficits causing higher inflation. In late 1980 and early 1981, in order to reduce its deficits, and partly in response to pressure from the International Monetary Fund, the GSL reduced planned 1981 investment expenditures from Rs.15.5 billion to Rs.12.0 billion.

The July 1980 World Bank report for the AID Group Meeting recognized Sri Lanka's growing requirements for assistance to finance planned investment and to relieve the deteriorating balance of payments. The Bank recommended that donors shift from project assistance to more rapidly disbursing aid, and the Sector Support Loan was intended to meet some of the needs identified by the Bank's report.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Karachi made an audit of the Mahaweli Sector Support Loan in Sri Lanka. The audit was conducted during December 1984 and January and February 1985 and covered activities for the period from May 29, 1981 through December 31, 1984. The primary objective of the audit was to review compliance with AID regulations and policies and with the terms of the Loan agreement. A further objective was to review program results. This was the first audit of the Loan.

We reviewed files and interviewed officials at the AID Mission and at the GSL agencies responsible for implementing the Loan. We reviewed vouchers reimbursing the GSL for \$32.5 million of program expenditures and the files at the Central Bank of Sri Lanka documenting the drawdown of letters of credit amounting to \$27.2 million. We made such other tests and reviews that we considered necessary. The audit was made according to generally accepted government audit standards.

We discussed our findings and conclusions at an exit conference with USAID/Sri Lanka officials and submitted a draft report for Mission review and comment. The Mission response was considered when preparing the final report.

AUDIT OF
MAHAWELI SECTOR SUPPORT LOAN
SRI LANKA

PART II - RESULTS OF AUDIT

A. Findings and Recommendations

1. The Sector Support Loan Has Not Met All of Its Objectives

The Sector Support Loan has not provided all of the assistance outlined in the PAAD. The program loan was intended to generate local currency to help the GSL carry on essential downstream activities of the Mahaweli program and to provide quick-disbursing balance of payments assistance. Because of delays in getting funds to the GSL the Loan has not had the intended economic impact. The GSL has claimed reimbursement of Loan funds much more slowly than was anticipated. In adapting the Loan to AID and GSL requirements the Loan was designed to reimburse the GSL for expenditures through an unrestricted special letter of credit (USLC) instead of immediately generating the needed local currency. As a result, the GSL made the initial program expenditures using rupees that contributed to its ongoing deficit for the time from when the funds were expended until they were drawn from the USLC.

The USLC through which the GSL was reimbursed was to be a fast-disbursing source of foreign exchange that would also increase imports from the United States. The GSL, however, did not draw the first foreign exchange funds from the USLC until over 2 years after the loan agreement was signed. The loan has not resulted in increased imports from the United States; funds in the USLC's have been drawn using completed procurement transactions that would have been made regardless of the Sector Support Loan. We have not made recommendations for altering the program because of the June 30, 1985 completion date of the Loan.

The report that evoked the response in Appendix 1 was the initial draft of this report. After discussions with Mission officials and reviewing their written comments, we revised the report. We believe that the report now reflects the Mission's concerns regarding the Loan's principal objective.

Discussion

The purpose of the Sector Support Loan was to assist the GSL carry on the Mahaweli program during a time of budget deficits. The PAAD stated that the Loan was to generate non-inflationary local currency and also provide quick-disbursing balance of payments assistance that would increase imports from the United States. The Loan was also intended to reduce the amount of borrowing the GSL would otherwise have to do to finance a given level of expenditures. The purpose was to be achieved through the influence the loan would have on the Mahaweli program budget. First priority for use of the loan funds was to be given to downstream activities that the GSL could implement without expatriate assistance. The second priority was for downstream activities other than those in the first priority for which expatriate design and supervision was arranged from AID or other donors. The third priority was for headworks construction for which expatriate design and supervision had been arranged from other donors.

As shown in the following table, the Loan funds have been used very slowly. The GSL's first expenditures were made in the period from June 1, 1981 through October 30, 1981, but the funds reimbursing these expenditures were not drawn from the USLC until July 15, 1983, more than two years after the first expenditures.

Sector Support Loan Status of Funds
(In Millions of Dollars)

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>Total</u>
Obligated by AID	18.8	15.0	16.2	-	50.0
GSL Expenditures	8.5	10.0	8.7	13.4	<u>1/</u> 40.6
Reimbursed-USLC Opened	-	8.5	11.3	12.7	32.5
USLC Funds Drawn	-	-	12.4	14.8	27.2

1/ Includes GSL expenditures of \$8.1 million for the last two quarters of 1984 for which the claims were processed after December 31, 1984.

The PAAD proposed an implementation procedure that would generate the local currency to be expended for the program. The Loan, however does not generate local currency for expenditure, but reimburses the GSL for local currency expenditures through an USLC. The Loan only generates local currency when Sri Lankan importers purchase the foreign exchange from the USLC. During the life of the Loan the GSL has had a national budget deficit; expenditures have exceeded income. Because the GSL had to provide the funds for the expenditures that were to be reimbursed by the Sector Support Loan,

those expenditures contributed to the national deficit and increased domestic borrowing for the time from when the rupees were expended until they were replaced with importers' deposits.

Also, the Loan has had little, if any, influence on increasing imports from the U.S. The GSL has not used the USLC to pay the U.S. suppliers, but instead has drawn-down the USLC's using completed transactions, i.e., those in which the goods or services had been previously paid for with the GSL's own foreign exchange. The funds in the USLC's are only applied after the fact to transactions that were made with no knowledge of the funds in the USLC's, and they would have been made whether or not the funds in the Sector Support Loan USLC's were available.

The PAAD seems to have anticipated a more rapid rate of expenditure for downstream activities than was realized. The GSL has not spent the amounts originally planned for the approved downstream works as shown in the following table:

Sector Support Loan Program Expenditures
(In millions of rupees)

		<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Planned	<u>1/</u>	340.0	502.0	470.0	512.8
Actual		175.4	228.7	216.9	352.3

1/ Planned expenditures included unallocated amounts; in 1982 of Rs.189 million, in 1983 of Rs.205 million, and in 1984 of Rs.56 million. The budget stated that the unallocated amounts could subsequently be allocated to the major activities included in the budget or to additional activities by mutual agreement.

Use of the Loan funds has been slower than anticipated for several reasons. First, because construction of the AID-financed main canal in System B has been delayed about a year by adverse conditions, including two unusually wet monsoon seasons, the related downstream works have had to be delayed. Second, funds from other donors have also been available, and because of the restrictions and cumbersome procedures involved in the use of the AID Sector Support Loan funds the GSL generally used funds from the other donors first. Third, during the early years of the Loan, the GSL was engaged in the construction of the four large dams that make up a major part of the Mahaweli program headworks. Although headworks were given third priority for use of Loan funds the Mission never reimbursed the GSL for headworks expenditures. Budget restrictions sometimes required spending on the headworks at the expense of downstream activities. Finally, during the life of the Loan the value of the Sri Lankan rupee declined against the dollar, with the result that the Loan provided substantially more rupees than originally planned.

Although according to the PAAD the Loan was intended to generate rupees for spending on the Mahaweli program, the Loan, as it was finally designed, does not generate rupees for program expenditures. When planning the Loan, cash transfers for the direct purchase of rupees or generation through a commodity import program (CIP) were considered, but the USLC mechanism was selected because cash transfers would not ensure spending the Loan dollars in the United States and a CIP would involve a substantial administrative burden. Because the purpose of the loan was related to the use of local currency, AID's USLC ground rules require that the rupees are irrevocably and unconditionally available to AID at the time the USLC is established. Under Sri Lankan law, however, an irrevocable USLC may not be accepted as an asset against which rupees may be disbursed. Both governments' requirements were met by having the USLC's reimburse the GSL for local currency expenditures. The Loan eventually generated the rupees to replace those spent on the Mahaweli program, but that generation only took place when the foreign exchange from the USLC's was purchased with rupees by Sri Lankan importers, in some cases over two years after the original expenditures were made.

The GSL was slow in drawing down the funds in the USLC's, because of the low volume of trade with the United States and unfamiliarity with the USLC procedures. The Loan has not encouraged increased imports from the United States because the funds have not been used to finance actual procurement but have been applied only to transactions after the fact. The GSL has identified import transactions in its foreign exchange account that are used to draw the funds from the USLCs. After applying the first two USLC's to large wheat purchases, the GSL was hard pressed to find other transactions for drawing-down the USLC's. During 1984, however, the rate of draw-downs increased.

It is difficult to assess the results of the Loan because the objectives are loosely defined. The objective was to ensure a minimum level of expenditures in the downstream activities of the Mahaweli program and to provide quick-disbursing balance of payments assistance. The Loan has provided valuable support for the downstream activities of the Mahaweli program, but it has fallen short of providing the intended economic assistance. The GSL did not draw the first funds from the Loan until July 1983, three years after the need for more rapidly disbursing aid had been identified. At December 31, 1984 only \$27.2 million of the \$50 million dollar Loan had been drawn.

The justification for a program loan instead of project assistance arose out of the 1980 AID Group Meeting recommendation that donors give more rapidly disbursing assistance for the growing requirements of the planned development investment program. The economic concerns that gave rise to the Sector Support Loan do not seem to have been

emphasized when the Loan was written and the Loan supported activities implemented. The reimbursement procedure resulted in long delays in getting the Loan funds to the GSL. The reluctance to fund headworks activities meant that most of the GSL's expenditures for the Mahaweli program, when the four major dams were under construction, were not reimbursed. Although headworks activities were excluded to ensure that downstream activities would continue, in view of the GSL's strong support for the Mahaweli program, this concern appears to have been misplaced.

Conclusion

The Sector Support Loan was initially proposed as a means of quickly transferring resources to the GSL, and because of AID's involvement in the Mahaweli program, the Loan was tied to assistance to that program, particularly to activities that would support AID's project in System B. Thus, the Loan had two objectives; project support and economic/balance of payments assistance. GSL use of the funds for the approved downstream project support activities proved to be much slower than anticipated. This resulted in substantially lessening the intended economic impact of the Loan. Corrective action should have been taken to move the Loan funds more rapidly when the Mission realized that the Loan was not providing the intended economic assistance. Possible actions could have included revising the reimbursement mechanics of the Loan and reimbursing the headworks activities. In view of the June 30, 1985 termination date of the Loan, however, we are making no recommendation.

2. The Mission Has Not Reviewed Reimbursement Claims According to the Intent of the Program

The purpose of the Loan was to assist the GSL carry on the Mahaweli program during a period of budget deficits. Because the program was intended to provide general budgetary assistance and not to procure specific goods and services, claims for reimbursement were not intended to be monitored in detail. To ensure that the AID funding could not be attributed to specific goods and services, the Mission placed limits on the amounts it would reimburse for a given quarter. In spite of this limitation, the Mission has reviewed individual transactions included in each reimbursement claim and disallowed individual items included in the claim as if it were financing the procurement of these specific goods and services.

Recommendation No.1

We recommend that the Director, USAID/Sri Lanka, implement the Sector Support Loan as intended, i.e., apply the reimbursement limitation and treat reimbursements as general budgetary support. Other than ascertaining that expenditures are eligible under the loan agreement, do not review individual procurement transactions.

Management Response

After reviewing the draft report the Mission reported that it had changed its review procedures in accordance with our recommendation. We confirmed that the change had been made as recommended.

OIG Response

As of the date of this report, we consider this recommendation closed.

Discussion

The purpose of the Loan was to assist the GSL maintain essential levels of local currency investment in the Mahaweli program during a period of budget deficits. Where the primary purpose of AID assistance is to be achieved through the use of AID-financed local currencies instead of the AID appropriated dollars, AID's statutory procurement restrictions and related policies apply to the use of the local currencies to the extent that the local currencies are associated with or can be traced to the procurement of specific goods or services.

The Sector Support Loan was never intended to be associated with specific local currency expenditures. The generated rupees were to be programmed against line items in the GSL budgets. The Loan was not to result in an increase in the level of Mahaweli investment for a given year, but was to be a non-inflationary means of permitting the GSL to finance what it had planned and budgeted to do. The Loan would reduce the amount of domestic borrowing required to finance a given level of expenditures. The PAAD went on to say that this concept of the Loan assumed that all donor and GSL resources are commingled.

AID was to reimburse the GSL based on reports of expenditures for the agreed upon activities. The GSL was not to be required to set up special accounts to trace AID rupees to their specific use. AID concerns would be met if the GSL accounts showed that the amounts budgeted from all sources of financing for a given line item had been expended for that purpose and that the intended physical accomplishments had been achieved. Since the purpose of the loan would be achieved when the GSL expended adequate amounts for downstream development activities, review of GSL reports and appropriate investigation of problems were the only formal monitoring of the use of the Loan required. These reviews could be supplemented by occasional visits to the program areas, but the activities were not to be monitored as project funded activities.

The PAAD also recognized that, in spite of the Loan's covenant limiting AID's contribution over the life of a project, for a given quarter AID could reimburse the GSL for 100 percent of a project's expenditures. The possibility of AID financing a high percentage of the rupee expenditures for a given period raised questions about the potential applicability of AID's procurement regulations. If AID funds were used for 100 percent of one quarter's expenditures, then it would not be possible to say that AID was only providing general budgetary support and was not, in fact, financing the goods and services that were paid for during that quarter. To avoid the possibility of financing specific goods and services, the Mission decided to limit the amounts reimbursed in any quarter to the lesser of either (1) 75 percent of the amount expended during a period after subtracting the amounts other donors provided for specific goods and services, or (2) the amount expended during a period after subtracting the total amount of financing provided by other donors.

In spite of the intention of the program to provide assistance at the budget line item level and the provisions made for ensuring that payments could be made in accordance with this intent, the Mission never treated the loan as general budgetary assistance. Beginning with the first reimbursement the Mission has monitored the specific amounts included in the amounts claimed, and excluded items considered inappropriate for AID financing, such as police infrastructure, land procurement, taxes, and operational costs.

Beginning with the third request for reimbursement, the GSL has included a detailed listing of all expenditures included in each claim. Although the Mission has monitored the specific items included in each claim, it has continued to apply the reimbursement limitation criteria that were intended to make monitoring of specific items unnecessary.

In spite of the reimbursement limitations that were instituted to ensure that monitoring could be disassociated from specific transactions, Mission officials did not want AID funds to be associated with activities that normally would not be eligible for AID financing. They were reluctant to accept the program loan concept of general budget assistance and monitored the Loan financed activities in much the same way they would a project.

The increased level of review has resulted in more disallowances than were intended. Through December 31, 1984, USLC's amounting to \$32.5 million have been issued to reimburse the GSL for local currency expenditures. That amount was reimbursed after the claims were reduced by \$8.9 million. The \$8.9 million includes both the amounts required to apply the reimbursement limitation, and the amounts that were disallowed because they were considered ineligible for AID funding, contrary to the intent of the Loan. The payment procedure that was adopted required the GSL to prepare lists of expenditures. Both the preparation of the claims and the subsequent review by the Mission involved unnecessary work that resulted in some delay in processing the claims. A USAID foreign national employee spent about half of his time reviewing claims.

Conclusion

The PAAD states that the Loan was intended to help finance certain line items in the GSL's Mahaweli program budget and was not to be identified with specific procurement. In order to avoid identification with specific procurement, the Mission imposed limitations on the amounts to be reimbursed. In implementing the Loan, the Mission has both monitored specific items included in each request for reimbursement and imposed the reimbursement limitations. We believe that this represents a misapplication of the Loan provisions. The Mission should monitor the Loan as general budgetary assistance according to the guidelines in the PAAD.

B. Compliance and Internal Control

1. Compliance

Our audit tests showed satisfactory compliance with the Loan agreement and AID regulations and policies. Nothing came to our attention to indicate that untested items were not in compliance with applicable laws and regulations.

2. Internal Control

The principal internal control deficiency noted in our audit was the Mission management's failure to ensure that the program was monitored according to the intent of the PAAD. This resulted in the Mission making a more detailed review of the reimbursement claims than was necessary, and we made a recommendation to revise the level of review. We found that the other internal controls related to the implementation of the loan were operating effectively.

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APPENDIX A

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AIDAC

FOR DONALD RYDER, AUDITOR

RECD: June 5, 1985
 1320 Hours

F.C. 12356: N/A

SUBJECT: DRAFT AUDIT REPORT - MAHAWELI SECTOR SUPPORT
 - PROJECT (383-0078)

ACTION: RIG/A

1. SUMMARY. FOLLOWING ARE USAID/SRI LANKA COMMENTS ON DRAFT AUDIT REPORT PREPARED BY DONALD RYDER ON THE MAHAWELI SECTOR SUPPORT PROJECT (383-0078). COMMENTS REFLECT DEBRIEFING HELD WITH RYDER ON MAY 28, 1985. THIS CABLE ON SUBSTANCE OF COMMENTS BELOW MAY BE INCORPORATED INTO FINAL AUDIT REPORT. END SUMMARY.

2. USAID/SRI LANKA CONSIDERS THE PRIMARY OBJECTIVE OF THE PROJECT TO HAVE BEEN ASSURANCE OF ADEQUATE GSI BUDGETS FOR CARRYING OUT DOWNSTREAM ACTIVITIES IN SYSTEMS B, C AND H OF THE ACCELERATED MAHAWELI PROGRAM (AMP). WE BELIEVE THIS OBJECTIVE HAS BEEN ACHIEVED, WITH DOLS. 40.6 MILLION IN RUPEE EQUIVALENT PROVIDED BY THE GSL THROUGH DECEMBER 31, 1984 AND THE FULL DOLS. 50.0 MILLION IN RUPEE EQUIVALENT ANTICIPATED TO BE APPROVED BY USAID BY THE JUNE 30, 1985 PACD. HAD THE USAID PROJECT NOT BEEN AVAILABLE, IT IS OUR JUDGEMENT THAT THE DOWNSTREAM WORK WHICH HAS NOW BEEN COMPLETED WOULD BE CONSIDERABLY BEHIND SCHEDULE. WITH SPECIFIC REFERENCE TO SYSTEM B, IN WHICH USAID UNDER TWO SEPARATE PROJECTS HAS FUNDED THE CONSTRUCTION OF THE MAIN AND BRANCH IRRIGATION CANALS, THE ASSOCIATED DOWNSTREAM WORKS FINANCED BY THE GSL (E.G., TERTIARY CANALS, SOCIAL AND ADMINISTRATIVE INFRASTRUCTURE) ARE BEING COMPLETED ON TIME TO MAKE USE OF THE MAIN AND BRANCH CANALS AS THE LATTER ARE FINISHED. THESE WORKS ARE AT THE TAIL END OF THE AMP AND WOULD LOGICALLY HAVE BEEN THE VICTIM OF BUDGET CUTS IN THE ABSENCE OF THE SECTOR SUPPORT PROJECT.

3. THE TOTAL ESTIMATED RUPEE EQUIVALENT OF THE FULL DOLS. 50.0 MILLION IN APPROVED GSL DOWNSTREAM EXPENDITURES IS RUPEES 1,224.8 MILLION OVER THE LIFE OF PROJECT, TAKING INTO CONSIDERATION CHANGES IN THE RUPEE/DOLLAR EXCHANGE RATE. THIS REPRESENTS 153.1 PERCENT OF PLANNED GSL EXPENDITURES OF RUPEES

800.0 MILLION.

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4. REGARDING USAID'S MANAGEMENT OF THE PROJECT, THE DECISION NOT TO ADMIT THE FINANCING OF LOCAL COSTS OF HEADWORKS AS AN ELIGIBLE ITEM FOR REIMBURSEMENT IS REGARDED AS AN ESSENTIAL MOVE TO ENSURE AN INCENTIVE FOR THE GSL TO CONTINUE TO PROVIDE FUNDS FOR DOWNSTREAM (AND GENERALLY LOWER PRIORITY) ACTIVITIES. THE DISALLOWANCE OF IDENTIFIABLE TAXES AND POLICE INFRASTRUCTURE WAS CONSISTENT WITH FOREIGN ASSISTANCE ACT RESTRICTIONS. THE DISALLOWANCE UNTIL THE FINAL STAGES OF THE PROJECT OF LAND EXPROPRIATION COSTS AND ADMINISTRATIVE (RECURRENT COST) OVERHEADS WAS ALSO PRUDENT MANAGEMENT IN VIEW OF THE OBJECTIVE OF FOCUSING THE PROJECT ON THE COMPLETION OF PHYSICAL INFRASTRUCTURE AND USAID'S RESTRICTIVE POLICIES ON THE FINANCING OF RECURRENT COSTS.

5. THE PERCENTAGES OF GSI CLAIMS FOR REIMBURSEMENT APPROVED BY USAID WERE 78.4 PERCENT IN 1981, 75.4 PERCENT IN 1982, 82.9 PERCENT IN 1983, 91.0 PERCENT IN 1984 AND ARE PROJECTED AT 93.3 PERCENT IN 1985. AS THESE PERCENTAGES DEMONSTRATE, THERE WAS NO FIXED LIMITATION TO 75 PERCENT FOR USAID APPROVALS, AND THE TREND IN 1984 AND 1985 SHOWED A MARKED IMPROVEMENT OVER THE 1981-1983 PERIOD.

6. THE SECONDARY EXPECTED BENEFITS OF THE PROJECT WERE (A) NON-INFLATIONARY GENERAL BUDGET SUPPORT, (B) FAST-DISBURSING FOREIGN EXCHANGE ASSISTANCE, AND (C) INCREASED IMPORTS FROM THE UNITED STATES. ON BALANCE, WE CONSIDER THE PROJECT TO HAVE HAD ONLY A MODEST EFFECT ON THE RATE OF INFLATION, WHICH IS SUBJECT TO MANY FORCES BEYOND THE GSL EXPENDITURES ATTRIBUTED TO THE PROJECT. DRAWDOWNS BY THE GSL ON THE SPECIAL LETTER OF CREDIT WERE SLOWER THAN ANTICIPATED, DUE PRIMARILY TO FAVORABLE SHIFTS IN THE GSL'S FOREIGN EXCHANGE REQUIREMENTS SUBSEQUENT TO THE START OF THE PROJECT. ALSO, AS PROCEDURES FOR ACCESS TO THE SPECIAL LETTER OF CREDIT WERE BETTER IMPLEMENTED, DOLLAR DISPURSEMENTS AGAINST ELIGIBLE U.S. IMPORTS INCREASED RAPIDLY AND ARE NOW CONSIDERED CURRENT WITH APPROVED CLAIMS FOR RUPEE EXPENDITURES ON DOWNSTREAM ACTIVITIES. FINALLY, WE

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AGREE THAT THE PROJECT HAS NOT CONTRIBUTED TO A
GENERAL INCREASE IN IMPORTS FROM THE U.S. REED
BT
#3764

NNNN

UNCLASSIFIED COLOMBO 003764/02

LIST OF REPORT RECIPIENTSUSAID/Sri Lanka

Director	5
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AID/W

Bureau For Asia and Near East

Assistant Administrator (AA/ANE)	2
Office of Pakistan, Nepal and Sri Lanka Affairs (ANE/PNS)	1
Audit Liaison Officer	1

Bureau For Science and Technolgoy

Assistant Administrator (AA/S&T)	2
Office of Agriculture (S&T/AGR)	3
Office of Rural and Institutional Development (S&T/RD)	1
Audit Liaison Officer	1

Bureau For Program and Policy Coordination

Program and Policy Evaluation Division (PPC/CDIE/PPE)	1
Development Information Division (PPC/CDIE/DI)	2

Bureau For Management

Assistant to the Administrator for Management (AA/M)	1
Office of Financial Management (M/FM/ASD)	2

Directorate for Program and Management Services

Office of Management Operations (M/SER/MO)	1
Office of Contract Management (M/SER/CM)	1

Bureau For External Relations

Office of Legislative Affairs (EXRL/LEG)	1
Office of General Counsel (GC)	1
Office of Public Affairs (OPA)	2

Office of Inspector General:

Inspector General (IG)	1
Communications and Records Office (IG/EMS/C&R)	12
Policy, Plans and Program (IG/PPP)	1

Regional Inspectors General for Audit:

RIG/A/Cairo	1
RIG/A/Dakar	1
RIG/A/Manila	1
RIG/A/Nairobi	1
RIG/A/Tegucigalpa	1
RIG/A/Washington	1

Other

RIG/II/Karachi	1
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