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AUDIT OF
LATIN AMERICAN AND CARIBBEAN AID
MISSIONS' MONITORING OF AND CONTROLS OVER
COUNTERPART CONTRIBUTIONS

AUDIT REPORT NO. 1-500-87-07
NOVEMBER 26, 1986

November 26, 1986

MEMORANDUM

TO : AA/LAC, Dwight A. Ink
FROM : D/IG, James B. Durnil *(General advised (for))*
SUBJECT: Audit of Latin American and Caribbean AID Missions'
Monitoring of and Controls over Counterpart Contributions

This report presents the results of audit of Latin American and Caribbean (LAC) Missions' monitoring of and controls over counterpart contributions. The objective of this limited-scope financial and compliance audit was to determine whether LAC Missions verified that host countries actually made agreed-to contributions.

The Missions in the LAC region generally did not monitor counterpart contributions closely enough to verify that required contributions were actually made. On the other hand, several positive examples of individual close monitoring were found during the review. These examples illustrate what can be accomplished when maintaining control over host country contributions is a management priority.

The findings in this report describe the need for LAC Missions to more closely control counterpart contributions during project implementation and project close-out. The report recommends that periodic reporting by host countries be required on counterpart contributions and that project close out procedures be improved.

Your offices agreed that host country contributions needed to be controlled more closely, but advocated that any new requirements be made flexible and simple to implement. Please advise this office within 30 days of the actions planned or taken to implement the report recommendations.

Thank you for the courtesies extended to the staff during this review.

EXECUTIVE SUMMARY

Section 110 of the Foreign Assistance Act, as amended, requires that 25 percent of the cost of bilateral, government-to-government AID development assistance projects be borne by the host country. The intent of this provision is to ensure host country commitment to AID projects, and to discourage over-reliance on external funds for development. AID has, as a matter of policy, extended the requirements of Section 110 to operational program grants. We estimate that required counterpart contributions for active projects in the Latin America and Caribbean region totaled more than \$1 billion as of September 1985.

The Office of the Regional Inspector General for Audit/Tegucigalpa conducted a limited scope financial and compliance audit to determine whether Latin American and Caribbean Missions verified that agreed-to counterpart contributions were actually made.

In general, Missions in this region did not monitor host country contributions closely enough to determine if required contributions were actually made. On the other hand, certain individuals in several Missions had implemented sound control systems, and the Missions in Panama and Jamaica had implemented controls which were generally superior to those in the other Missions reviewed. The positive examples found during the audit showed that proper controls can be put in place when management and staff place adequate priority on controlling counterpart contributions.

The findings in this report describe the need to more closely control host country contributions during project implementation and during the project close-out process. The audit also identified a need for a clear policy on what exchange rate should be used for computing and determining whether local currency contributions comply with requirements denominated in U.S. dollars. This area is currently being reviewed in more detail by the Office of the Inspector General's Legal Counsel.

AID Missions should closely monitor the amounts host countries contribute to AID-sponsored programs. The importance of closely monitoring counterpart contributions is underscored by the legislative intent of Section 110 of the Foreign Assistance Act as well as the fact that host country contributions account for about two of every five dollars budgeted for AID development assistance projects in this region. A monitoring system which could measure compliance or non-compliance with the level of contributions required by the project agreements was in place for only thirteen of the 44 active projects reviewed. Only five of these thirteen monitoring systems also provided timely management information. Missions in the Latin America and Caribbean region did not monitor counterpart contributions more closely mainly because Mission officials: (1) thought it was more important to ensure that contributions were sufficient to support project activities than to measure compliance, and they thought they could do this without establishing formal monitoring systems; (2) believed the effort required to formally monitor counterpart contributions would outweigh the

benefits derived; and (3) felt existing guidance did not specify how closely Missions should monitor host country contributions. As a result, AID did not have sufficient assurance that required contributions equivalent to about \$1 billion would actually be made. We recommend that AID Missions require periodic reports on counterpart contributions, as a condition of disbursing AID funds. Management generally agreed with this finding and recommendation, but urged that the administrative burden from new reporting requirements be minimized.

AID Handbook 3 requires the preparation of project assistance completion reports which, among other things, are to include a summary of contributions by the borrower/grantee, donors, and participants. Good management practice would dictate that counterpart contributions be quantified and verified, so that AID can determine whether or not mutually agreed-to contributions were actually made. AID had not determined the actual amount of counterpart contributions for 36 of the 43 completed projects reviewed, and no completion report of any kind had been prepared for 29 of the 43 projects. Preparing project completion reports was assigned a low priority, given other demands on project officers' time. Coupled with loose monitoring of counterpart contributions during project implementation, this situation reinforces the conclusion that AID lacked sufficient assurance that required contributions were actually made. We recommend that Missions address the adequacy of project close-out procedures in their annual vulnerability assessments under the Federal Managers' Financial Integrity Act. Management concurred in this finding and recommendation.

Office of the Inspector General

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PART I - INTRODUCTION

A. Background

Section 110 of the Foreign Assistance Act of 1961, as amended, provides that:

No assistance shall be furnished by the United States Government to a country under sections 103 through 106 of this Act until the country provides assurances to the President, and the President is satisfied, that such country provide at least 25 per centum of the costs of the entire program, project or activity with respect to which such assistance is to be furnished, except that such costs borne by such country may be provided on an "in-kind" basis.

A Senate Foreign Relations Committee report states that the intent of this provision is "[t]o insure that the recipient country has a vested interest in the success of an AID-financed project or activity" It further states that ". . . the country should be required to pay for an increasing portion of the project cost, in accordance with its ability to pay." While Section 110 of the Foreign Assistance Act is applicable only to bilateral, government-to-government projects funded with development assistance appropriations, AID has administratively extended this requirement to operational program grants. In many cases, Economic Support Fund project agreements also include counterpart funding provisions. However, the latter type of project was not included in this review.

While the minimum host country contribution is 25 percent, most AID Missions in the Latin America and Caribbean (LAC) region have required borrower/grantees to contribute a much higher proportion of total project costs: the average in our sample of 44 active projects was 41 percent. We estimate that, region-wide, required counterpart contributions may total more than \$1 billion as of September 30, 1985. ^{1/}

This audit was undertaken because several past audits indicated that weak controls over host country contributions could be a region-wide problem.

^{1/} Obligations of development assistance funds in the LAC region, excluding regional projects, totaled \$1,566,768,000 as of September 30, 1985. Our estimate is calculated as follows:

AID share of Development Assistance-funded projects	\$ 1,566,780,000 (59%)
Counterpart contributions	<u>1,088,771,000 (41%)</u>
Total	\$ 2,655,551,000

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa conducted a limited-scope financial and compliance audit to determine whether IAC Missions verified that counterpart contributions agreed to were actually made. The audit covered 44 active and 43 completed projects with planned counterpart contributions of \$252 million and \$167 million, respectively. The projects were selected using judgment sampling techniques designed to include both large and small projects, in different stages of implementation, and in as many different technical offices as possible.

The projects were managed by ten of the fourteen IAC Missions, plus the Office of the Development Affairs Attache in Paraguay (see Appendices 1 and 2). The Missions in Barbados, Bolivia, and Ecuador were not included because previous audits showed that weaknesses in monitoring counterpart contributions existed in those Missions. The Regional Office for Central American Programs was not included because it manages regional projects for which, as a matter of policy, counterpart contributions are not required.

The audit included interviews with cognizant AID officials and, in a limited number of cases, with host country officials. The principal records reviewed were project agreements, reports, evaluations, audits, and other documents demonstrating how AID monitored and exercised control over counterpart contributions.

The audit work was performed from April 7 through June 6, 1986. It covered Mission monitoring of counterpart contributions through December 31, 1985. The audit was made in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

In general, Missions in the Latin America and Caribbean region did not perform sufficient monitoring or establish adequate controls to ensure that host country contributions agreed to were actually made.

On the other hand, certain individuals in several Missions had implemented sound controls. Also, in Panama and Jamaica, controls over counterpart contributions, while not all-inclusive, were clearly superior to those in the other Missions reviewed. To illustrate, USAID/Panama received reports on counterpart contributions for four of the five active projects reviewed, and was developing a Mission-wide system for planning and reporting on the use of host country contributions. The sophistication of the reports was quite high in some cases. For example, one project officer for the Development Policy Studies project was working with the implementing agency to help them allocate office rental costs based on net, rather than gross, square footage. The positive examples found during the audit show what can be accomplished when maintaining controls over counterpart contributions is a management priority.

Counterpart contribution monitoring systems were deficient for 31 of the 44 active projects reviewed. Actual contributions were not reconciled during project close-outs for 36 of the 43 completed projects covered by the audit. In countries where the value of the local currency fluctuated relative to the U.S. dollar, responsible officials were uncertain what exchange rate should be used to calculate the value of contributions in local currency. This was an important issue since borrower/grantees normally agreed to provide contributions equivalent to a specific amount of U.S. dollars. This issue is currently under further review by the Office of the Inspector General's Legal Counsel.

The report recommends that more specific guidance on controlling counterpart contributions be developed and that project close-out procedures be strengthened.

A. Findings and Recommendations

1. Contributions Should Be Monitored More Closely During Project Implementation

AID Missions should closely monitor the amounts host countries contribute to AID-sponsored programs. The importance of closely monitoring counterpart contributions is underscored by the legislative intent of Section 110 of the Foreign Assistance Act as well as the fact that host country contributions account for about two of every five dollars budgeted for AID development assistance projects in this region. A monitoring system which could measure compliance or non-compliance with the level of contributions required by the project agreements was in place for only thirteen of the 44 active projects reviewed. Only five of these thirteen monitoring systems also provided timely management information. Missions in the Latin America and Caribbean (LAC) region did not monitor counterpart contributions more closely mainly because Mission officials: (1) thought it was more important to ensure that contributions were sufficient to support project activities than to measure compliance, and they thought they could do this without establishing formal monitoring systems; (2) believed the effort required to formally monitor counterpart contributions would outweigh the benefits derived; and (3) felt existing guidance did not specify how closely Missions should monitor host country contributions. As a result, AID did not have sufficient assurance that required contributions equivalent to about \$ 1 billion would actually be made.

Recommendation No. 1

We recommend that the Assistant Administrator for Latin America and the Caribbean direct Bureau Missions to obtain borrower/grantee reports on their contributions to projects on a regular basis, as a condition of disbursing AID funds.

Discussion

In Section 3.2 of the standard language for AID project agreements, (contained in AID Handbook 3, Chapter 6), the borrower/grantee:

agrees to provide or cause to be provided for the Project all funds . . . and all other resources required to carry out the Project effectively and in a timely manner. The resources provided by [the borrower/grantee] for the Project will be not less than the equivalent of U.S.\$ _____, including costs borne on an "in kind" basis [emphasis supplied].

In our opinion, Missions (in particular, project officers) should monitor counterpart contributions closely enough to confirm that borrower/grantees actually meet the level of contributions specified in project agreements, as well as the 25 percent minimum statutory contribution where it applies. Our position is based on the legislative

intent underlying Section 110 of the Foreign Assistance Act, and on the importance of counterpart contributions to the success of AID's development assistance activities.

A monitoring system which met this criteria was in place for only thirteen (30 percent) of the 44 active projects reviewed. Only five of these thirteen monitoring systems also provided timely information to project managers.

The monitoring methods used by project officers included informal methods (e.g., maintaining a general knowledge of project activities and progress, conversations with host country personnel, etc.), the use of evaluations and audits to determine the actual amount of counterpart contributions, and periodic reports (monthly, quarterly, or annually) submitted by borrower/grantees. Two Missions went further: USAID/Honduras regularly audited supporting documentation for Title I local currency used as counterpart on AID projects, and USAID/Costa Rica was about to hire a local accounting firm for the same purpose. Appendix 1 provides more information on the methods used to monitor host country contributions to the projects included in our review.

The LAC Missions covered by this review did not monitor counterpart contributions more closely because:

- They believed that it was more important to ensure that contributions were sufficient to support project activities than to measure compliance, and they believed that this could be accomplished using informal monitoring methods.
- Mission management believed that the effort required to formally monitor counterpart contributions would be greater than the benefits.
- Mission management assigned a low priority to monitoring counterpart contributions, given other demands on project officers' time.
- Existing guidance did not specify how closely Missions should monitor host country contributions.

Given the importance of host country contributions to the success of AID projects, Missions should be concerned both with measuring compliance with the level of contributions specified in project agreements (and the 25 percent minimum statutory contribution, as applicable), and with ensuring that contributions are timely and adequate to support project activities. We do not believe, in most cases, that Missions can fulfill either responsibility without establishing some sort of formal monitoring system. Many, perhaps most, Mission personnel believe that Mission staffing levels constrain their ability to fulfill all their monitoring responsibilities. Indeed, roughly half the audit reports this office has issued since 1984 cite Mission monitoring weaknesses as an attendant cause of implementation problems. Given this circumstance, and the fact that monitoring host country contributions is often accorded low priority, it would seem unwise to rely on project officers' general

cognizance of project activities to ensure that contributions are adequate to support project implementation, or that they comply with the levels specified in project agreements and the Foreign Assistance Act.

In most cases, Mission staff overestimated the effort required to formally monitor host country contributions. If they require borrower/grantee reports on counterpart contributions, and simply review these reports to assess whether host country expenditures have been made as agreed and whether reported expenditures are reasonable in view of what has been accomplished, the amount of time project officers would have to devote to monitoring host country contributions would be relatively insignificant. Of course, if an implementing agency is not presently accounting for its contributions, the project officer may have to spend more time at the outset helping the agency develop an acceptable reporting system.

As a result of monitoring weaknesses, AID had insufficient assurance that a substantial amount of required contributions would actually be made. We estimate that, region-wide, required counterpart contributions totaled more than the equivalent of \$1 billion. If all of these contributions are not made, fewer resources will be available to accomplish project objectives. While this review did not attempt to identify shortfalls in counterpart contributions, several audit reports this office issued in 1986 did identify serious shortfalls. For example, an audit of USAID/Honduras' Natural Resources Management project (report No. 1-522-86-25) disclosed that the Government of Honduras' support for the project fell far short of the agreed levels. An audit of the Agricultural Marketing Development project in Jamaica (report No. 1-532-86-73) showed that the same problem had adversely affected several projects in that country. Readers may also wish to refer to audit report Nos. 1-511-86-09, 1-521-86-10, and 1-527-86-16 for other examples of cases where counterpart shortfalls adversely affected project implementation.

A secondary effect of weak monitoring of counterpart contributions was that both AID and host country officials lacked information needed for project management. That is, they lacked information needed to compare project inputs and outputs, evaluate project costs and benefits, and initiate timely corrective actions.

AID Missions in the LAC region needed to monitor counterpart contributions more closely, to ensure that borrower/grantees fulfilled their obligations and to ensure that needed resources were made available in a timely manner. Annual reporting by borrower/grantees would permit the Missions to verify compliance with the level of contributions specified in project agreements. More frequent reporting would provide them with information they need to manage project inputs and evaluate project costs and benefits. Requiring those reports as part of the documentation supporting requests for disbursement of AID funds will ensure that they are submitted in a timely fashion.

Management Comments

The Assistant Administrator for Latin American and the Caribbean agreed that Missions should measure actual counterpart contributions through a formal reporting mechanism. He maintained that Missions already required reports on planned and actual contributions, and that therefore the problem for most Missions was to ensure compliance with existing reporting requirements. Regarding the frequency of reporting, he believed that annual reporting would be adequate to measure compliance with agreed-to contributions, and would also minimize the administrative burden on AID and the host country. He thought that reporting on counterpart contributions should be incorporated into existing reports to the extent possible. He did not think that reports on host country contributions should be made a formal pre-condition to disbursement of AID funds, however.

Several Missions that provided comments on the draft report urged that any reporting requirement be made as flexible as possible. They were concerned that formal monitoring of counterpart contributions might take time away from other, higher priorities, such as maintaining control over AID funds. They also doubted that there was a massive shortfall of counterpart contributions in the region.

Some Missions also suggested that Section 110 of the Foreign Assistance Act should be repealed or modified.

Office of Inspector General Comments

Responding first to the Assistant Administrator's comments, we found that most Missions require borrower/grantees to submit budgets for host country contributions, but do not require reporting on actual contributions. Thus, implementing the recommendation will require modifying existing reports or developing new reporting systems, rather than just enforcing existing requirements.

We agree that annual reporting is adequate to measure compliance. On the other hand, it would not be adequate in all cases for project management (i.e., comparing project inputs and outputs and making adjustments where necessary). We do not think that quarterly reporting on host country contributions is always necessary, (for example, on small projects where the level of contributions are very stable), and therefore have modified the recommendation to leave the frequency of reporting to management's discretion. We continue to believe that quarterly reporting is necessary on large projects where the level of contributions does fluctuate significantly. We expect that Mission management will require quarterly reporting where it is applicable.

We agree that reports on counterpart contributions should be incorporated into existing reporting systems whenever possible. If annual reporting is required, reports on actual contributions for the previous year could be included with the budget for the following year. Quarterly reports would most appropriately be included with requests for disbursement of AID funds.

We continue to believe that reports on counterpart contributions should be made a formal condition of disbursement of AID funds. Our experience has shown that it is difficult to obtain compliance with any financial reporting requirement unless it is made a pre-condition to disbursement of AID funds.

Turning to the Missions' comments, the present recommendation is responsive to the Missions' request that reporting requirements be made as flexible as possible. We agree that maintaining control over AID funds should be accorded a higher priority than maintaining control over counterpart contributions. The massive amount of resources involved and the importance of counterpart contributions to project implementation, though, makes monitoring counterpart contributions a close second priority, in our view. We urge IAC Missions to continue to take steps to improve project oversight, such as funding project monitors with project funds and assigning some monitoring responsibilities to technical assistance teams.

We are uncertain whether or not there has been a massive shortfall of counterpart contributions in this region. Given the low level of effort applied to monitoring these contributions, this can only be a matter for speculation. Since we estimate that planned contributions totaled over \$1 billion, even a small percentage shortfall would represent a major loss of resources for implementing AID projects.

Whether Section 110 of the Foreign Assistance Act should be changed is an interesting question which was outside the scope of our review. We recognize that some AID recipients may be hard pressed to comply with Section 110 as it is now written. On the other hand, given current pressures on AID's and other federal agencies' budgets, we doubt that Congress would respond favorably to this proposal, especially in light of the fact that a large proportion of counterpart contributions are actually generated by other AID resource transfers such as Public Law 480 Title I commodity sales proceeds and Economic Support Fund cash transfers.

2. Contributions to Most Completed Projects Were Not Reconciled

AID Handbook 3 requires the preparation of project assistance completion reports which, among other things, are to include a summary of contributions by the borrower/grantee, donors, and participants. Good management practice would dictate that counterpart contributions be quantified and verified, so that AID can determine whether or not mutually agreed-to contributions were actually made. AID had not determined the actual amount of counterpart contributions for 36 of the 43 completed projects reviewed, and no completion report of any kind had been prepared for 29 of the 43 projects. Preparing project completion reports was assigned a low priority, given other demands on project officers' time. Coupled with loose monitoring of counterpart contributions during project implementation, this situation reinforces the conclusion that AID lacked sufficient assurance that required contributions were actually made.

Recommendation No. 2

We recommend that the Assistant Administrator for Latin America and the Caribbean require Missions to address the adequacy of project close-out procedures in the annual vulnerability assessments required by the Federal Manager's Financial Integrity Act. Project completion reports (or end-of-project evaluations, if no project completion report is prepared) should include the information required by Appendix 14A of AID Handbook 3.

Discussion

AID Handbook 3, Appendix 14A, requires that project assistance completion reports be prepared within six months of project completion. Among other things, the reports should include a "summary of contributions made by the [borrower/grantee], donors and participants (i.e. planned versus actual inputs)." Sound management practice would require that the reports quantify host country contributions, so that AID can determine whether contributions agreed to were actually made.

AID did not determine the actual amount of counterpart contributions for 36 (84 percent) of the 43 completed projects reviewed. No project assistance completion report, final evaluation, or final audit of any kind was prepared for 29 (67 percent) of the 43 projects. Appendix 2 provides additional information on the completed projects reviewed.

This situation existed because preparing reports on completed projects was accorded low priority, given other demands on project officers' time. Together with weak monitoring of host country contributions during project implementation, the failure to reconcile contributions upon project completion reinforces the conclusion that AID did not have sufficient assurance that agreed-to contributions were actually made. In addition, when project completion reports are not prepared, a potentially valuable opportunity to learn from past experience is lost.

Project assistance completion reports serve as an important means of communicating lessons learned, and of demonstrating compliance or non-compliance with the level of counterpart contributions required by project agreements. The Bureau Assistant Administrator should see that Missions address the adequacy of project close-out procedures in the annual vulnerability assessments required by the Federal Manager's Financial Integrity Act of 1982. 1/

Management Comments

The Assistant Administrator for Latin America and the Caribbean generally agreed with our recommendation, but noted that final evaluations, if they contain the required information, can satisfactorily substitute for project completion reports prepared by project officers. He suggested that the recommendation be modified to explicitly recognize this fact.

Office of Inspector General Comments

We recognized that final evaluations can effectively substitute for close-out reports prepared by project officers. This finding was based on the fact that no project assistance completion report, final evaluation, or final audit of any kind was prepared for 29 (67 percent) of the 43 completed projects reviewed. We have modified the recommendation, however, to more explicitly recognize that final evaluations can be designed to meet the requirements for project completion reports.

1/ In October 1981, the Office of Management and Budget issued Circular A-123, Internal Control Systems. Circular A-123 directed agency heads to establish and maintain improved control systems and make regular reviews to see that the controls are functioning. Circular A-123 was reinforced and strengthened by the Federal Manager's Financial Integrity Act of 1982. Among other things, federal agencies are now required to conduct annual vulnerability assessments of their programs and functions. A vulnerability assessment is a diagnosis of an operating unit's susceptibility to loss, damage, or operational difficulties due to fraud, waste, or abuse.

B. Compliance and Internal Controls

Compliance

The audit disclosed three compliance exceptions:

- Frequently, project assistance completion reports were not prepared as required (Finding 2).
- The counterpart contributions required for USAID/Honduras' Private Sector Population Program fell short of the 25 percent minimum required by AID policy (following report section).
- Some project agreements executed by USAID/Guatemala and USAID/Jamaica denominated host country contributions in local currency, rather than in U.S. dollars as required by AID Handbook 3 (following report section).

Other than the conditions cited, tested items were in compliance with applicable laws and regulations, and nothing came to our attention which would indicate that untested items were not in compliance.

Internal Controls

The audit revealed four internal control exceptions:

- In most cases, LAC Missions did not monitor host country contributions closely enough to ensure that agreed-to contributions would actually be made (Finding 1).
- LAC Missions usually did not verify, during the project close-out process, that required contributions had actually been made (Finding 2).
- No agency policy existed which specified what exchange rate should be used to determine compliance with the level of contributions specified in project agreements (normally stated in U.S. dollars) and with the 25 percent minimum statutory requirement (following report section).
- Some project agreements signed by the AID Missions in Guatemala and Jamaica denominated host country contributions in local currency. This introduced the risk that actual contributions, because of exchange rate fluctuations, would not meet the 25 percent minimum statutory requirement (following report section).

C. Other Pertinent Matters

1. Exchange Rate for Computing Counterpart Contributions - AID policy requires that Missions use the most favorable exchange rate which is not unlawful when they exchange dollars for local currency. Logically, the same rate should be used to determine whether borrower/grantees have provided the counterpart contributions required by project agreements (which are normally stated as the equivalent of a specific amount of U.S. dollars), and whether they have provided the statutory minimum of 25 percent of the total project cost, where applicable. In five countries included in this review, the local currency had devalued relative to the dollar, and Mission officials were uncertain what exchange rate should be used to determine the equivalence of local currency contributions to U.S. dollars. No agency guidance existed specifying what exchange rate should be used to calculate counterpart contributions when the value of local currency fluctuated in relation to the dollar. Using the most favorable exchange rate available instead of a less favorable rate could result in additional contributions of between \$45 million and \$95 million annually in five LAC countries. These additional contributions could permit AID dollars to be used for other productive purposes or returned to the U.S. Treasury, if not needed. This policy matter is receiving further review by the Office of the Inspector General's Legal Counsel.

2. Honduras/Operational Program Grant - AID has, as a matter of policy, extended the statutory minimum 25 percent counterpart contribution requirement to operational program grants. However, the agreement for USAID/Honduras' Private Sector Population Program required the grantee to contribute only 23 percent of the total project cost. According to the project officer, this level was considered sufficient since the grantee's contributions were projected to rise from 20 to 26 percent over the life of the project. The project agreement needed to be amended to ensure that required contributions of at least \$249,750 would be obtained. On September 30, 1986, USAID/Honduras signed a project agreement amendment which required a 25 percent counterpart contribution.

3. Paraguay/Project Close Out - The Office of the Development Affairs Attache in Paraguay had contracted for a final audit of its Minifundia Crop Intensification project, but had not followed up on one recommendation that the implementing agency make additional contributions to the project. In response to our inquiries, a follow-up review was done which showed that the agency made additional contributions of \$110,832 subsequent to the final audit.

4. Project Agreements - Section 3.2 of the standard language for AID project agreements, included in AID Handbook 3, requires that the borrower/grantee resources for the project will be "not less than the equivalent of U.S. \$ _____, including costs borne on an 'in-kind' basis." The agreements for two USAID/Guatemala projects and one USAID/Jamaica project that we reviewed, however, denominated host country contributions in local currency. Since the value of the local currency did not remain constant in relation to the U.S. dollar, an unnecessary exchange risk was introduced, and actual host country contributions might

not reach the minimum 25 percent level. USAID/Guatemala officials stated that until recently, this was common practice there, since the Government of Guatemala was reluctant to agree to provide counterpart contributions denominated in dollars. USAID/Jamaica officials did not know why host country contributions for one project were expressed in local currency, but stated that this was an isolated case. Previous audit results lead us to believe that this problem was not restricted to the two Missions mentioned above. In his comments on the draft report, the Assistant Administrator for Latin America and the Caribbean stated that a sample review of 36 project agreements had, with the exception of Guatemala, found no additional variations in the standard language concerning host country contributions. At the same time, USAID/Jamaica conducted a review of all its project agreements and did find another variation from the standard language. While we are not making a formal recommendation, the Assistant Administrator should direct Missions under his control to review their portfolio and amend project agreements where necessary to bring them into compliance with the standard language in AID Handbook 3.

5. Information System - No information system on either planned or actual host country contributions existed in AID/Washington. Such a system would help AID/Washington officials exercise oversight of field activities, since without this information it is impossible to accurately measure the magnitude, scope, or progress of project activities. The semiannual progress reports now submitted to AID/Washington could easily be modified to include this information. We suggest that the Bureau for Program and Policy Coordination and/or the Bureau for Management develop a system which includes information on both planned and actual counterpart contributions.

6. Counterpart Funds Reporting - The information in the Office of Financial Management's W-213 report, "Status of Foreign Currency Funds Administered by the Agency for International Development," did not appear to be complete. For example, the September 30, 1985 report did not include any information on Economic Support Fund or P.L. 480 Title I generated local currencies held in special accounts in Honduras, although it did include information on the same type of accounts in other countries. We noted similar discrepancies in the information on, for example, El Salvador and Peru. We suggest that the Office of Financial Management determine the reasons for these discrepancies and correct them.

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PART III - APPENDICES

UNIT OF
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Summary Information on Active Projects

<u>Country/Project</u>	<u>Project No.</u>	<u>Required Life of Project Counterpart Contributions (\$000)</u>	<u>Percent of Total Project Cost</u>	<u>Actual Counterpart Contributions 12/31/85 (\$000)</u>	<u>Comments</u>
<u>GUATEMALA</u>					
Livestock Development	565-0006	1,180	48	Not available.	Monitored informally (i.e., through knowledge of project activities, contact with counterparts, etc.). Implementing agency had begun to submit quarterly reports (first report covered January through March 1986) which showed all contributions except salaries.
Village health and Sanitation	565-0021	600	46	146	Monitored informally. Actual contributions shown are taken from a one-time report submitted by the implementing agency.
<u>COSTA RICA</u>					
Family Planning Self-Reliance	315-0144	3,000	54	936	Monitored informally, and through annual audited financial statements.
Private Sector Low Cost Shelter	315-0145	118	28	N/A	Monitored informally. An upcoming interim evaluation was to determine amount of counterpart contributions.
Policy, Planning, and Administration Improvement	315-0150	2,450	25	N/A	Monitored informally.
Northern Zone Infrastructure Development	315-0151	10,700	31	N/A	Mission reports showed P.L. 480 Title I local currency released to implementing agencies. In addition, project officer approved each land purchase made with Title I funds. In-kind contributions monitored informally.

<u>United Project</u>	<u>Project No.</u>	<u>Requested Title of Project Counterpart Contributions (\$000)</u>	<u>Percent of Total Project Cost</u>	<u>Actual Counterpart Contributions (\$000)</u>	<u>Comments</u>
<u>TECHNOLOGY ASSISTANCE</u>					
National Resources Management	117-0118	10,200	48	5,450 1/2	Monitored through quarterly reports.
Graduate Management Training	117-0117	8,892	80	8,700	Monitored through annual reports. Actual contributions shown are calculated using an average exchange rate of 3.17 pesos to 1 dollar.
Agricultural Sector Training	117-0116	1,400	34	124 1/2	Monitored informally.
Essential Appropriate Technology (EAT)	117-0114	294	18	N/A	Monitored informally.
Applied Technical Education	117-0113	700	34	N/A	Monitored informally.
Rural Roads II	117-0111	18,000	55	1,400	Monitored informally. Figure shown for actual contributions was provided by the implementing agency and converted to dollars at an average exchange rate of 3.17 pesos to 1 dollar.
<u>II. MANAGE</u>					
Industrial Stabilization and Recovery	125-0227	1,017	28	N/A	Title I funds monitored to point of release to the implementing agency. In-kind contributions monitored informally.
Health Systems Utilization	125-0225	12,400	28	N/A	Title I funds monitored to point of release to the implementing agency. In-kind contributions monitored informally.

1. This reported figure overstates actual counterpart contributions since it uses an official exchange rate which was eliminated in January 1971.

2. Report officer's estimate.

<u>Country Project</u>	<u>Project No.</u>	<u>Reported % of Project Counterpart Contributions (\$K)</u>	<u>% of Total Project Cost</u>	<u>Actual Counterpart Contributions Q. 1978 (\$K)</u>	<u>Comments</u>
<u>EL SALVADOR (cont'd)</u>					
Community-Based Integrated Rural Development	121-0200	420	30	5.3	Monitored informally.
<u>GUATEMALA</u>					
Rural Electrification	121-0248	12,300	14	5,866	Monitored through quarterly reports. However, reports intermingled AID and counterpart contributions for some line items. Actual contributions shown are taken from a one-time report which did not include construction labor costs.
Community-Based Integrated Health and Nutrition Systems	121-0252	C. 11,400	3.3	C. 4,095	Monitored informally. Actual contributions shown here are taken from a one-time report prepared by the implementing agency. Because counterpart contributions in the loan agreement were stated in quetzales, the percentage of total project costs could not be calculated.
Small Farmer Electrification Systems	121-0255	6,700	82	2,572 1/2	Project officer had one report on counterpart contributions and planned to make this a recurring requirement.
Non-Formal Education	121-0281	C. 2,344	3.3	C. 262	Monitored through quarterly E/G reports. Because counterpart contributions in the loan agreement were stated in quetzales, the percentage of total project costs could not be calculated.

1/ Calculated at 1 quetzal to 1 dollar. When we performed our audit, the parallel exchange rate was 2.65 quetzales to 1 dollar.

<u>Country/Project</u>	<u>Project No.</u>	<u>Approved Est. of Project Contributions (\$000)</u>	<u>Percent of Total Project Cost</u>	<u>Actual Contributions (\$000)</u>	<u>Comments</u>
<u>INDIA</u>					
Dissemination Agricultural Development	121-0078	10,500	41	N/A	Title I funds monitored through Mission system to point of release to implementing agency.
Family Planning Outreach	121-0024	6,000	40	N/A	Title I funds monitored through quarterly expenditure reports (last report received covered quarter ending September 1985). Other contributions monitored informally.
Strengthening Rural Credit Services	121-0121	6,000	35	N/A	Title I funds monitored through Mission system. Other contributions monitored informally.
Community Integrated Nutrition/Education Centers	121-0138	400	28	270 1/2	Monitored informally.
Management of Malaria	121-0145	4,500	13	N/A	Title funds monitored through Mission system. Other contributions monitored informally.
<u>INDONESIA</u>					
Small Farmer Cattle Development	121-0178	4,480	21	7,320 1/2	Use of Economic Support Funds local currency monitored through periodic reports (timeframe charges depending on credit activity). Other contributions monitored informally.
Small Farmer Training	121-0073	4,000	25	2,176 1/2	Monitored informally.
Health Sector I	121-0113	15,780	34	17,590	Monitored through reports attached to each request for disbursement of AID funds.

1/ Project officer's estimate.

<u>Country/Project</u>	<u>Project No.</u>	<u>Required Life of Project Counterpart Contributions (\$000)</u>	<u>Percent of Total Project Cost</u>	<u>Actual Counterpart Contributions 12/31/87 (\$000)</u>	<u>Comments</u>
<u>JAMAICA (cont'd)</u>					
Rural Primary Education	311-0217	12,333	35	5,105 ^{2/}	Use of Economic Support Funds local currency monitored through monthly reports. Other contributions monitored informally. Community contributions are not included in the estimate shown.
Private Sector Population Program	311-0280	2,457	23	N/A	According to the project officer, the implementing agency planned to submit reports on counterpart contributions. However, he expected that it would require assistance to develop meaningful reports. He also stated that the level of contributions required was thought to be adequate since the agency's contributions will increase from 20 to 26 percent over the life of the project.
<u>JAMAICA</u>					
Health Management Improvement	332-0064	3,267	25	N/A	The implementing agency has submitted one report which showed life of project contributions through December 31, 1984, in Jamaican dollars. It will submit annual reports for each following year.
Energy Sector Assistance	332-0065	15,768	65	4,988	Monitored through quarterly reports. The figure shown is calculated using an average life-of-project exchange rate of 3.39 Jamaican dollars to 1 dollar.

^{2/} Estimate taken from one-time report prepared by implementing agency.

<u>Country/Project</u>	<u>Project No.</u>	<u>Approved Use of Project Counterpart Contributions (\$000)</u>	<u>Percent of Total Project Cost</u>	<u>Actual Counterpart Contributions 12/31/85 (\$000)</u>	<u>Comments</u>
<u>JAMAICA (cont'd)</u>					
Population and Family Planning	522-0065	12,422	66	6,833 1/	One set of reports has been received, which shows contributions as of March 31, 1986. The Mission has requested quarterly reports. The figure shown is calculated using an average exchange rate of 3.40 Jamaican dollars to 1 dollar.
Agro-Industrial Development	522-0091	10,368	52	2,712	According to the project officer, he had been receiving both quarterly and monthly reports on counterpart contributions, but the last report received was for March 31, 1985. The figure shown is taken from a project evaluation report, and is calculated using an average exchange rate of 3.92 Jamaican dollars to 1 dollar.
Agricultural Cooperative Development	531-0107	J\$ 1,500	N/A	J\$ 781	Monitored informally. Actual contributions shown are taken from a one-time report submitted by the implementing agency. Because counterpart contributions in the project agreement were stated in Jamaican dollars, the percentage of total project costs could not be calculated.
<u>JAMAICA</u>					
Agricultural Cooperative Marketing	525-0222	445	35	284 2/	Monitored through quarterly reports.
Agricultural Technology Transfer	525-0227	6,340	45	2,058	Monitored through quarterly reports.

1/ Information as of March 31, 1986.

2/ Estimate.

<u>Country</u> <u>Project</u>	<u>Project No.</u>	<u>Secured</u> <u>Life of Project</u> <u>Counterpart</u> <u>Contributions</u> <u>(\$000)</u>	<u>Percent</u> <u>of Total</u> <u>Project</u> <u>Cost</u>	<u>Actual</u> <u>Counterpart</u> <u>Contributions</u> <u>12/31/85</u> <u>(\$000)</u>	<u>Comments</u>
<u>IANNA (Cont'd)</u>					
Investment Council of Iannana	525-0239	8,110	67	3,689	Monitored informally. Mid-term evaluation determined amount of contributions through 12/31/85.
Small Business Development	525-0240	8,100	47	\$26 ^{1/}	Monitored through reports sent when contributions are actually made. Reports do not include in-kind contributions.
Development Policy Studies	525-0250	1,000	45	370	Monitored through annual reports.
<u>IBL</u>					
Agricultural Research, Extension, and Education	527-0192	5,100	25	N/A	Title I contributions monitored to point of commitment by implementing agency. The Mission's Title I monitoring system could not demonstrate compliance or non-compliance with the project agreement because (1) local currency commitments were converted to dollars at the official exchange rate, rather than a more favorable legal "financial" rate; and (2) no data on expenditures was accumulated.
Rural Water Systems and Sanitation	527-0221	5,200	32	N/A	Monitored through the Mission's Title I monitoring system.

1/ Estimate.

<u>Country/Project</u>	<u>Project No.</u>	<u>Required Life of Project Counterpart Contributions (\$000)</u>	<u>Percent of Total Project Cost</u>	<u>Actual Counterpart Contributions 12/31/85 (\$000)</u>	<u>Comments</u>
<u>FIRO (Cont'd)</u>					
Small Hydro Plants Development	527-0226	6,356	39	2,163 ^{1/}	Monitored through the Mission's Title I monitoring system, through quarterly reports on the construction component (which converted local currency to dollars at the official rate), and through informal methods.
Integrated Family Planning and Health	527-0230	4,850	27	N/A	Monitored through the Mission's Title I monitoring system. Efforts were being made to obtain meaningful reports on counterpart contributions from the implementing agencies.
Vocational Education	527-0266	204	36	181	Monitored informally. Actual contributions shown are taken from a one-time report submitted by the implementing agency.

^{1/} Includes contributions to the construction component only, calculated at the official rate of exchange.

AGIT OF
LATIN AMERICAN AND CARIBBEAN AIR
MISSIONS' MONITORING OF AND CONTROLS OVER
GOVERNMENT CONTRIBUTIONS

Summary Information on Completed Projects

<u>Country/Title</u>	<u>Project No.</u>	<u>Required Counterpart Contributions (\$000)</u>	<u>Actual Counterpart Contributions (\$000)</u>	<u>Percent of Actual Total Project Cost</u>	<u>Comments</u>
<u>COSTA RICA</u>					
Community Systems	711-0114	7,500	N/A	N/A	No project assistance completion report, final evaluation, or final audit report on file.
Food, Employment and Community Development	711-0112	41,200	11,154	27	Audit report showed that the Government of Costa Rica had spent 56 percent of its planned contribution as of July 1983 -- five months before the project assistance completion date.
Environmental Education II	711-0113	241	11	4	Final evaluation showed that grantee contributions fell short of the planned amount. According to the Controller, the grantee's ability to provide adequate contributions was one reason why \$21,593 was deobligated from the project.
Greater Sector Productivity	711-0117	10,500	10,172	10	Amount shown does not include in-kind contributions.
Language School Improvement II	711-0111	40	N/A	N/A	No close-out report on file.
<u>PANAMA</u>					
Education Sector Loan	717-0113	7,500	N/A	N/A	No close-out report on file.
Health Care Reform and Rationalization	717-0111	17,820	N/A	N/A	No close-out report on file.
Health, Education, and Community Services	717-0114	112	N/A	N/A	Final evaluation did not address counterpart contributions.
Private Sector Loan	717-0112	112	N/A	N/A	Implementing agency prepared a final report which did not address counterpart contributions.

Country/Region	Project No.	Approved Counterpart Contribution \$1000	Actual Counterpart Contribution \$1000	Approved Total \$1000	Actual Total \$1000	Comments
<u>PHILIPPINES</u>						
Nutrition Improvement	711-0134	274	N/A	N/A	N/A	No close-out report on file.
Small Farmer Development	711-0134	1,200	N/A	N/A	N/A	No close-out report on file.
Rural Home-by Education	711-0134	3,836	N/A	N/A	N/A	No close-out report on file.
Rural Water Supply and Sanitation	711-0134	401	N/A	N/A	N/A	No close-out report on file.
<u>THAILAND</u>						
Small Farmer Development	721-0173	8,153	N/A	N/A	N/A	No close-out report on file.
Rural Enterprise Development	721-0173	1,170	N/A	N/A	N/A	No close-out report on file.
Integrated Education	721-0173	1,110	N/A	N/A	N/A	No close-out report on file.
Education Administration	721-0173	410	N/A	N/A	N/A	No close-out report on file.
Integrated Family Planning Services	721-0173	711	N/A	N/A	N/A	Final evaluation did not address counterpart contributions.
Development Administration Improvement	721-0173	406	N/A	N/A	N/A	Final evaluation quantified counterpart contributions only for the first two project years.
<u>INDIA</u>						
Agricultural Feeder Roads	721-0074	1,650	N/A	N/A	N/A	No close-out report on file.
Small Farmer Marketing	721-0083	1,280	1,828 ¹	11	11	No close-out report on file. Estimate shown is taken from evaluation completed one and a half years before the FACD.

1. Estimate.

<u>Country Title</u>	<u>Project No.</u>	<u>Required Counterpart Contributions (\$000)</u>	<u>Actual Counterpart Contributions (\$000)</u>	<u>Percent of Actual total Project Cost</u>	<u>Comments</u>
<u>HAITI (cont'd)</u>					
Highway Maintenance II	521-0084	27,412	N/A	N/A	No close-out report on file.
Cros Notre Rural Development II	521-0142	118	103 ^{1/}	21	Final evaluation did not address counterpart contributions. Figure shown for actual contributions is taken from the last Mission progress report.
Community Water Systems/Small Farmer Irrigation	521-0147	182	N/A	N/A	Final evaluation did not address counterpart contributions.
<u>HONDURAS</u>					
Environmental Education	522-0183	9	N/A	N/A	The project assistance completion report did not determine the amount of counterpart contributions.
Horizons of Friendship	522-0184	137	N/A	N/A	No close-out report on file.
Tegucigalpa Power Restoration	522-0226	674	N/A	N/A	No close-out report on file.
Development Assistance to the University of San Pedro Sula	522-0223	81	N/A	N/A	No close-out report on file.
Investment Development	522-9106.1	5	N/A	N/A	No close-out report on file.
<u>JAMAICA</u>					
Fish Production System Development	532-0059	4,858	N/A	N/A	No close-out report on file.
Integrated Rural Development	532-0046	11,200	N/A	N/A	An Inspector General audit report stated that, thirteen months before the project assistance completion date, the Government had contributed about \$5.6 million.

1 Estimate.

<u>COUNTRY TITLE</u>	<u>Project No.</u>	<u>Required Counterpart Contributions (\$000)</u>	<u>Actual Counterpart Contributions (\$000)</u>	<u>Percent of Actual Total Project Cost</u>	<u>Comments</u>
<u>PANAMA</u>					
Rural Growth and Service Centers	525-0185	10,400	10,400 <u>1/</u>	56	No project assistance completion report on file. An internal evaluation completed one year before the project assistance completion date stated that almost all of the counterpart contributions had been disbursed.
Rural Access Roads	525-0192	6,605	N/A	N/A	No close-out report on file.
Population II	525-0204	3,170	N/A	N/A	Final evaluation did not quantify counterpart contributions.
Alternative Energy Sources	525-0207	550	359	32	Final evaluation showed contributions only for the mini-hydro demonstration component.
Development Administration	525-0209	1,750	382	35	Final evaluation quantified counterpart contributions.
Managed Fish Production	525-0216	740	N/A	N/A	No close-out report on file.
• Employment Planning and Generation	525-0221	6,740	4,428 <u>2/</u>	46	No project assistance completion report on file, but borrower/grantee reports quantified contributions.
<u>PANAMA</u>					
Small Farm Technology	526-0109	3,657	N/A	N/A	Financial review showed counterpart contributions only in local currency, which could not be readily converted to dollars.
Minifundia Crop Intensification	526-0118	2,580	N/A	N/A	Financial review showed counterpart contributions only in local currency, which could not be readily converted to dollars.

1/ Estimate.

2/ This figure excludes \$1,514,813 in costs submitted to AIL for reimbursement but disallowed because they were not properly supported or not eligible, which a Controller's Office Accountant thought should be included as counterpart.

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<u>Country Title</u>	<u>Project No.</u>	<u>Required Counterpart Contributions</u> (\$000)	<u>Actual Counterpart Contributions</u> (\$000)	<u>Percent of Actual Total Project Cost</u>	<u>Comments</u>
<u>FHU</u>					
Pre-School Education	527-0161	1,176	N/A	N/A	An evaluation completed nine months before the project assistance completion date showed the percentage share of contributions by AID, the implementing agency, and the participating communities.
Sur-Medio Health Region	527-0224	907	N/A	N/A	No close-out report on file.
Urban Family Planning	527-0245	67	N/A	N/A	No close-out report on file.

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, DC 20523

MEMORANDUM FOR D/IG, James B. Durnil

SEP 29 1980

FROM: AA/LAC, Dwight Ink

SUBJECT: Response to Draft Audit Report on Latin American and Caribbean Missions/ Monitoring of and Controls of Counterpart Contributions

This memorandum provides the LAC Bureau's response to recommendations 1, 2, and 7 of the subject draft audit report.

Draft Recommendation 1: "We recommend that the Assistant Administrator for Latin American and the Caribbean direct Bureau Missions to obtain borrower/grantee reports on their contributions to projects on a regular basis (at least quarterly), as a condition of disbursing AID funds."

Response: LAC Bureau management is interested in assuring that Grantee/Borrower commitments are fully honored and that the intent of Section 110 of the FAA is fulfilled. We agree that Missions should monitor counterpart contributions more closely than has been the case in some LAC Missions in the recent past. Those Missions where there is non-existent or inadequate reporting of counterpart contributions will be expected to remedy this deficiency. I intend to raise this concern at the forthcoming LAC Bureau Mission Directors' Conference in October. We agree that Missions should assure that counterpart contributions be measured through a formal reporting system. However, we do not believe that it is necessary or advisable to make counterpart reports a formal condition of disbursement. Missions already require (usually in PIL No. 1) that planned and actual counterpart contributions be reported. The established mechanism provides a de facto mechanism to suspend disbursements by not approving the annual operating plan when, in the judgment of the Mission, counterpart is not being fully provided. We do not believe that, for most Missions, it is necessary to establish a new reporting system. Rather, it is a matter of assuring that B/G implementing agencies fulfill those reporting requirements which already exist. In this regard we wish to note that Congress frequently complains about the red-tape that we impose on host countries and ourselves. Therefore, we are striving to minimize the administrative burden which we place on host countries, particularly as we try to get them to reduce the size of their bureaucracy.

Regarding the frequency of reporting we believe that annual reporting is adequate for the Missions and the Bureau to assess the degree of compliance with counterpart contribution requirements.

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This is particularly true because of the issues involved in valuing or otherwise quantifying "in-kind" B/G contributions to projects. Given the annual planning and budgeting procedures followed in many countries it may be overly complex to track counterpart contributions on a quarterly basis. Such reporting does impose a real burden on host government implementing agency staff as well as A.I.D. project officers. Therefore it should not be required more often than is necessary and, preferably, should be included as an element of periodic reporting which is already required. (where lack of counterpart is a major constraint to project implementation the implementing agency and the A.I.D. project manager are acutely aware of this fact without receiving a formal report from the host government.)

In light of the above considerations, we suggest that the recommendation read "We recommend that the Assistant Administrator for Latin American and the Caribbean direct Bureau Missions to obtain borrower/grantee reports on a regular basis concerning their contributions to projects."

Draft Recommendation 2. "We recommend that the Assistant Administrator of Latin America and the Caribbean enforce the requirement for Missions to prepare project assistance completion reports and require them to address the adequacy of project close-out procedures in the annual vulnerability assessments required by the Federal Manager's Financial Integrity Act."

Response: We agree that it is appropriate that project close-out procedures are assessed in the annual vulnerability assessments. However, we do not feel that the lack of Project completion reports by project officers necessarily signifies that project close-out procedures have been neglected. Rather, many projects now have end-of-project evaluations which often cover many aspects of the project completion reports. Given the severe staff limitations which many missions face, we believe that the alternative of using evaluations to fulfill this requirement is appropriate. We would, however, expect that the scopes of work prepared for the evaluations include the items required by the project completion report. Therefore we suggest that the recommendation be reworded to state that: "We recommend that the Assistant Administrator of Latin America and the Caribbean require Missions to address the adequacy of project close-out procedures in the annual vulnerability assessments required by the Federal Manager's Financial Integrity Act. If end of project evaluations are done in lieu of project completion reports they should contain the information required by the latter as set forth in HB 3."

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Draft Recommendation 7: "We recommend that the Assistant Administrator for Latin America and the Caribbean direct the Missions under his control to review their project portfolios and amend any agreements which do not comply with the standard language required by AID Handbook 3."

Response: We have carried out our own internal review of a sample of project agreements for 36 recent projects in nine major bi-lateral programs in LAC project agreements (four per country) and, with the exception of Guatemala, have found no other variations from the standard language of HB 3. We therefore believe that this recommendation is unnecessary and that Draft Recommendations 5 and 6 adequately deal with the identified problem. We suggest that Draft Recommendation 7 be removed from the final report.

As an additional observation we wish to point out that it may not always make sense to require a minimum 25% contribution ex post host country (HC) contribution. For example, A.I.D. may cover all foreign exchange costs of a project while the HC covers all local currency costs (estimated to exceed 25% at the time of obligation and included as a HC commitment in the project agreement.) If there is a large depreciation of the local currency against the dollar (something which we frequently urge HCs to do) while the project is implemented but internal prices (especially wages which are likely to constitute a major portion of the HC contribution) do not increase by the full amount of the depreciation, the purpose of the project can be fully achieved without a full 25% HC contribution. We don't know whether or not this would create a legal problem (we are consulting with GC on the legal aspects of this issue) but, from a practical point of view the borrower would have met the requirements of the project.

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