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AUDIT OF  
USAID/GUATEMALA  
ESF PROGRAM

Audit Report No. 1-520-88-08  
January 22, 1988

AGENCY FOR INTERNATIONAL DEVELOPMENT

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January 22, 1988

MEMORANDUM

TO : USAID/Guatemala Director, Anthony J. Cauterucci  
FROM : RIG/A/T, *Coinage N. Gothard* Coinage N. Gothard  
SUBJECT: Audit of USAID/Guatemala ESF Program

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of USAID/Guatemala's ESF Program. Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains six recommendations. All the recommendations are unresolved and will be closed when the required actions have been completed. Please advise me within 30 days of any actions taken to implement the recommendations.

I appreciate the cooperation and courtesy extended to my staff during the audit.

Attachments: a/s

## EXECUTIVE SUMMARY

The first half of the 1980s witnessed a prolonged recession in Guatemala which served to reduce real per capita income by 16.5 percent. The economic decline was caused by a variety of unfavorable factors. The Guatemalan government first tried to counter the decline in output with expansionary fiscal policies, leading to rationing of hard currency and increased foreign borrowing. In addition, in 1985 Guatemala had a new democratically elected civilian government, the first in 30 years. The new administration entered with a serious commitment to economic policy reform. In response to this economic crisis and positive political change, USAID/Guatemala solicited economic support funds for the Government of Guatemala for balance-of-payments support to promote financial stabilization and economic recovery. The program operates according to cash transfer agreements which are signed between the United States Government and the Government of Guatemala.

The Office of the Regional Inspector General for Audit/Tegucigalpa made a program results audit of USAID/Guatemala's Economic Support Funds program. The audit objective was to determine if USAID/Guatemala and the Government of Guatemala had established adequate monitoring controls in order to ensure that the Economic Support Fund assets were adequately safeguarded and utilized for their intended purposes.

The audit found that neither USAID/Guatemala nor the Government of Guatemala had implemented monitoring systems in order to adequately safeguard Economic Support Fund assets from fraud and waste or to ensure that the funds were being utilized for intended purposes.

However, USAID/Guatemala wrote a Mission Order entitled, "Local Currency Programming" dated April 7, 1987, which, when implemented, will institute an active Economic Support Fund monitoring system. In addition, USAID/Guatemala was in the process of hiring two financial analysts to monitor these activities and an experienced A.I.D. contractor had been hired to train these people.

This report contains three findings. USAID/Guatemala's lack of a monitoring system led to faulty reporting, commingling of funds, lack of guidance on interest utilization and non-use of funds from 1986. In addition, due to a lack of monitoring, the 1986 dollar attributions <sup>1/</sup> could not be certified because 25 of the 50 transactions judgmentally sampled revealed that the imported goods came from ineligible sources or lacked documentation. Finally, the Government of Guatemala was not capable of fulfilling its auditing responsibilities.

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<sup>1/</sup> Economic Support Fund dollars used to buy acceptable imports as specified in the 1986 agreement.

According to Policy Determination No. 5 dated February 22, 1983, A.I.D. must monitor the use of Public Law 480 sales proceeds and assure that they are allocated to support economic development objectives. In 1984, the A.I.D. Administrator extended the policy to cover Commodity Import Program and cash transfers. At the time of our audit, USAID/Guatemala did not have a system in place to monitor Economic Support Funds local currency. According to the USAID/Guatemala Controller, USAID/Guatemala had no monitoring responsibilities over the program prior to the arrival of a new Director in August 1986. At that time, the Director instructed the Controller to develop a Mission Order which would outline USAID/Guatemala's Economic Support Fund monitoring system. A Mission Order was established in April 1987 but as of the end of our fieldwork, August 28, 1987, it has not been implemented. Without a local currency oversight system, USAID/Guatemala could not adequately monitor the program's \$113.35 million in local currency or determine whether program goals were achieved. As a result there were a number of problems with these funds. For example, reporting was faulty, funds were commingled, there was no guidance on interest use and funds from 1986 were idle. The report recommends that USAID/Guatemala develop a monitoring system to safeguard Economic Support Fund assets and obtain a General Counsel ruling on local currency interest earned. It also recommended that the Ministry of Finance provide written guidance to implementing agencies on separate accounts and year-end reporting and reassigning of funds.

The Mission disagreed with the finding, stating that previous Economic Support Fund programs for Guatemala had been small and many of the restrictions now required did not exist in those years. We disagreed with the Mission's position based on Policy Determination No. 5 dated February 22, 1983 and subsequent guidance.

The 1986 Economic Support Fund agreement held that the dollars provided were to be attributed to the import of certain eligible goods from the United States. The Bank of Guatemala was to provide evidence that the imported goods were eligible. A judgmental sample of 50 transactions of the 1986 dollar commodity list presented by the Bank of Guatemala to USAID/Guatemala disclosed that 25 of 50 1986 transactions sampled came from ineligible sources or lacked documentation. USAID/Guatemala did not provide the Bank of Guatemala with guidance to determine the necessary documentation of eligibility or guidance to determine commodity eligibility by source. Therefore, USAID/Guatemala could not rely on the commodity listing provided by the Bank of Guatemala to ensure that the 1986 tranche of \$47,350,000 was spent in accordance with the criteria set out in the 1986 agreement. The report recommends that the Mission evaluate the 1986 dollar attributions. The Mission stated the document the audit team referred to was a preliminary attribution list obtained prematurely at the auditor's insistence. We have not received any documentation from USAID/Guatemala to verify its position.

Under the 1986 Economic Support Fund agreements, the Government was to audit disbursements for Economic Support Fund local currency fund activities. The Government had not audited these activities. The Guatemalan agency responsible for auditing these monies claimed it did not have the capability to perform this function. As a result, the programs \$113.35 million in local currency had not been adequately

safeguarded and programs' results could not be properly evaluated. The Mission suggested wording changes in the recommendation, which we incorporated.

The complete text of the Mission comments is included as Appendix 1, followed by the Office of the Inspector General response as Appendix 2.

*Office of the Inspector General*

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USAID/GUATEMALA  
ESF PROGRAM

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PART I - INTRODUCTION

A. Background

The first half of the 1980s witnessed a prolonged recession in Guatemala which served to reduce real per capita income by 16.5 percent. The economic decline was caused by a variety of unfavorable factors, the most important of which were regional political instability and capital flight, declining export commodity prices and counterproductive macroeconomic policies.

The Guatemalan government first tried to counter the decline in output with expansionary fiscal policies. The Central Government deficit, which had averaged 2.8 percent of Gross Domestic Product (GDP) during the 1978 to 1980 period, grew to 7.4 percent of GDP in 1981 and 4.7 percent in 1982.

Weak fiscal policies helped create growing demand for foreign exchange at the same time that supply of hard currencies was shrinking due to capital flight and unfavorable commodity prices. By 1982, the Guatemalan authorities had resorted to rationing of scarce dollars, which resulted in the appearance of a black market. To maintain the increasingly unrealistic quetzal (Guatemalan unit of currency) parity with the dollar, nearly all of Guatemala's once substantial international reserves were expended. Gross reserves dropped from \$744.1 million at the end of 1978 to \$21.2 million by the end of 1982. At the same time, foreign borrowing increased. The outstanding external debt of the Central Bank, for example, rose from \$42 million in 1978 to \$485 million in 1982. By 1985, this totalled \$1,358 million, including arrearages. In addition, in 1985 Guatemala had a new democratically elected civilian government, the first in 30 years. The new administration entered with a serious commitment to economic reform policy.

In response to this economic crisis and the positive political changes, the Government of Guatemala (GOG) received economic support funds (ESF) for balance-of-payments support to promote financial stabilization and economic recovery.

The ESF program operates according to cash transfer agreements which are signed between the United States Government (USG) and the GOG. Basically, after the GOG meets certain conditions precedent, a dollar cash transfer is made by the U. S. Treasury to the Bank of Guatemala's account at the Federal Reserve Bank of New York. These dollars can be used, among other things, for importation from the United States of raw materials, agricultural inputs, construction materials, intermediate goods, capital machinery and equipment and spare parts for the Guatemalan private sector. At the time that the dollar cash transfer takes place,

it is the responsibility of the GOG to deposit the equivalent amount of local currency into a special account at the Central Bank of Guatemala at the highest rate of exchange which is not unlawful on the date of the dollar transfer. Disbursements from the local currency fund are made for development activities approved jointly by the GOG and A.I.D. as stipulated under the ESF agreements. In addition, an A.I.D. trust fund can be established from the local currency account in order to defray A.I.D. administrative expenses incurred in the operation of its programs.

The initial ESF program consisted of a \$10 million loan which was signed between the USG and the GOG on February 10, 1983. In 1985, projectized ESF funds 1/ consisting of a \$9.5 million loan and \$3 million grant were used to fund the Agribusiness Development project (520-0276). On June 6, 1986 the GOG signed an ESF agreement for \$47.35 million (\$23.925 million loan, \$23.425 million grant). On April 13, 1987 the GOG received an ESF grant for another \$56 million.

#### B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa made a program results audit of USAID/Guatemala's Economic Support Funds program. The audit objective was to determine if USAID/Guatemala and the Government of Guatemala had established adequate monitoring controls in order to ensure that the ESF assets were adequately safeguarded and utilized for their intended purposes.

The audit covered the period from February 10, 1983 to August 28, 1987 and included dollars and local currency generations of \$113,350,000.

In order to accomplish the audit objectives, we reviewed USAID/Guatemala and GOG files and interviewed officials of USAID/Guatemala, A.I.D./Washington Controller's office, U.S. State Department/Guatemala, U.S. Disbursing Officer/Mexico City, Central Bank of Guatemala, the Ministry of Finance, Ministry of Roads, Ministry of Public Works, the Ministry of Health, Agricultural Development Bank, Housing Bank and the National Institute for Electrification. In addition, the audit team conducted an on-site visit to observe the construction of a 50 kilometer road from Esquintla to Puerto Quetzal.

The audit team was not able to interview officials nor evaluate records at the GOG's Contraloria de Cuentas because of a personnel strike by GOG workers at the time of the audit.

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1/ Projectized funds were utilized in the same fashion as Development Assistance Funds for a specific project. Therefore these monies were not audited as part of the ESF program.

The judgmental sample methodology consisted of selecting the first commodity on the attribution list costing \$5,000 or more and every fifth commodity thereafter of the same value or greater. The commodity value of \$5,000 or more was selected because the Bank of Guatemala has a price-checking mechanism for commodities of this value or more.

Audit fieldwork was conducted from May 18, 1987 through August 28, 1987. The review of internal controls and compliance was limited to the ESF programs for 1983, 1986 and 1987. The audit was made in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The audit found that neither USAID/Guatemala nor the Government of Guatemala had implemented monitoring systems in order to adequately safeguard Economic Support Fund (ESF) assets from fraud and waste or to ensure that the funds were being utilized for intended purposes.

However, USAID/Guatemala issued a Mission Order entitled, "Local Currency Programming" dated April 7, 1987, which, when implemented, will institute an effective ESF monitoring system. In addition, USAID/Guatemala was in the process of hiring two financial analysts to monitor ESF activities and an experienced A.I.D. contractor had been hired to train these people.

This report contains three findings. USAID/Guatemala's lack of a monitoring system led to faulty reporting, commingling of funds, lack of guidance on interest utilization and non-use of funds from 1986. In addition, due to a lack of monitoring, the 1986 dollar attributions could not be certified because 25 of the 50 transactions judgmentally sampled revealed that the imported goods came from ineligible sources or lacked documentation. Finally, the Government of Guatemala was not capable of fulfilling its auditing responsibilities.

The report recommends that USAID/Guatemala (1) develop a monitoring system to safeguard ESF assets; and (2) evaluate the 1986 ESF dollar attributions. Additionally, the Ministry of Finance should (1) provide written guidance to implementing agencies to set up separate accounts and report on funds not expended by December 31, of each year; and (2) reassign all 1986 monies which have not been expended. The report also recommends that a General Counsel ruling be obtained on local currency interest earned, and the Contraloria de Cuentas comply with its auditing responsibilities.

The Mission provided lengthy comments on the draft report and requested that their comments be included verbatim in the body of the report. While space limitations preclude complying in all cases, we have summarized the Mission's comments and provided a precise reference to the relevant comments, which were included in full as Appendix 1.

## A. Findings and Recommendations

### 1. USAID/Guatemala Had Not Monitored the Uses of ESF Local Currency

AID policy states that the Agency must monitor cash transfers to ensure that such funds are used to support economic development objectives. USAID/Guatemala did not have a system to monitor local currency generated from Economic Support Fund (ESF) cash transfers. Mission managers had received no guidance in establishing such a system until April 1987. As a result, reporting was faulty, funds were commingled, interest was unused and 1986 funds were unutilized.

#### Recommendation No. 1

We recommend that USAID/Guatemala provide evidence that a monitoring system has been established and implemented to ensure that Economic Support Fund local currency generations are being properly utilized to accomplish program goals and are adequately safeguarded against fraud, waste and abuse.

#### Recommendation No. 2

We recommend that USAID/Guatemala obtain evidence that the Ministry of Finance has provided all Guatemalan implementing agencies with written guidance advising them:

- a. to set up separate accounts for their "AID-generated" local currencies so that these funds are not commingled with money from other sources; and
- b. how to make disposition of local currencies not expended by December 31 of each year.

#### Recommendation No. 3

We recommend that USAID/Guatemala request an AID General Counsel ruling as to whether any interest earned on Economic Support Funds should be utilized in the same manner as the originally programmed funds. If the General Counsel holds that interest earned should be utilized in the same manner as the originally programmed funds, then USAID/Guatemala should direct the Ministry of Finance to advise all implementing agencies with written guidance to take the appropriate action.

#### Recommendation No. 4

We recommend that USAID/Guatemala obtain evidence that the Ministry of Finance has reassigned all 1986 Economic Support Funds that have not been expended.

#### Discussion

According to A.I.D. Policy Determination No. 5 (PD-5) dated February 22, 1983 entitled, "Programming PL 480 Local Currency Generations," Title I legislation does not require formal A.I.D. involvement in programming the

expenditure of PL 480 sales proceeds, nor does it require recipient countries to deposit these proceeds into special accounts. Nevertheless, it contemplates some degree of A.I.D. involvement, since A.I.D. must monitor the use of the sales proceeds and assure that they are allocated to support economic development objectives. In 1984 the policy was extended to cover Commodity Import Programs (CIPs) and cash transfers (ESF Programs).

Guatemalan ESF local currency funds were not covered by a monitoring system or individual oversight. At the time of our audit, USAID/Guatemala did not have a monitoring system in place in order to track ESF local currency. Although a Mission Order entitled, "Local Currency Programming" had been issued on April 7, 1987, it had not been implemented by the end of the audit fieldwork, August 28, 1987. The audit revealed that no member of USAID/Guatemala's Controller's office had ever conducted a financial evaluation in order to evaluate the local currency uses under the ESF Program. In addition, discussions with several USAID/Guatemala project managers revealed that none was actively monitoring the use of local currency within their projects.

In the opinion of the USAID/Guatemala Controller, USAID/Guatemala had no monitoring responsibilities over the ESF program prior to the arrival of the new Director in August 1986. At that time, the Director instructed the Controller to develop a Mission Order which would outline USAID/Guatemala's ESF monitoring system. The previous "hands-off" approach had been the management position of the prior Director and A.I.D./Washington policy. The Controller stated this approach was fine until recent directives from both the Congress and A.I.D./Washington indicated that the Missions should be more active in monitoring the ESF Program.

Due to the lack of an adequate ESF local currency monitoring system, USAID/Guatemala was not in a position to detect and resolve problems with the program. For example, reporting was faulty, funds were commingled, there was no guidance on interest use, and funds from 1986 were idle.

Faulty Reporting - A good example of the importance of a monitoring system was brought out in an April 24, 1987 memorandum from the Mission Director to the Controller entitled, "ESF Local Currency and Dollar Tracking." According to the memo, a Mission staffer informed the Director of a number of inconsistencies and errors in the ESF local currency reports the Mission received from the Ministry of Finance. In addition there was some confusion caused by the reassigning of 1986 undisbursed local currency into the 1987 budget. The Mission Director required that this faulty reporting be cleared up with the Ministry of Finance and that the reports be reconciled so that local currency utilization could be adequately tracked.

The Mission Director requested the Controller to have his staff analyze the local currency records and prepare a list of anomalies so that they could be taken up with the Ministry of Finance. He suggested that it would be well to provide the GOG with general guidelines for improving reporting to better fulfill the ESF requirements. The Director also

suggested that the Controller's Office make contact with the Bank of Guatemala to set up guidelines for the dollar reporting and attribution under the 1986 ESF agreement. The Director's memorandum was discussed with the Controller, who had no clear recollection of it, had no file copy, and had done little to implement this guidance. A May 20, 1987 implementation letter only set out 1987 ESF dollar reporting requirement guidelines for the Bank of Guatemala. In addition, a Mission Order had been prepared concerning monitoring of ESF activities, but it had not yet been implemented. The Controller also mentioned that new staff would be responsible for monitoring the ESF activities. He had hired two financial analysts who were now in the process of obtaining security clearances and an experienced A.I.D. contractor was coming on board to train them.

Commingled Funds - A February 22, 1987 cable "ESF Cash Transfer Assistance - New Statutory Provisions" stated that, "in accordance with statutory provisions contained in the fiscal year 1987 Continuing Resolution, all countries receiving cash transfer assistance in excess of dollars (\$5 million) obligated after February 1, 1987 will be required to establish separate bank account(s) into which will be placed the dollar assistance and, if and as required by the cash transfer agreement, special account(s) for deposits of local currency." The House Appropriations Committee report accompanying the Continuing Resolution also directs that deposited local currency be trackable and not be commingled. In our opinion, the legislative history of the Continuing Resolution shows that end-users must maintain ESF local currency in separate bank accounts.

At the Agricultural Development Bank (BANDESA) we requested Bank officials to list how they had utilized the ESF and PL 480 monies disbursed to them. According to the BANDESA officials, this exercise was not possible because all the Bank's funds were commingled. We determined BANDESA had the equivalent of \$268,382 in ESF funds which could not be tracked. At the time of our audit, the BANDESA officials also said that the Bank had never been instructed by the Ministry of Finance to maintain a separate account for these funds. A Ministry of Finance official who was present at the interview said that, although verbal instructions had been issued to the implementing agencies on this matter, no formal written guidelines had ever been developed by the Ministry of Finance. In addition, USAID/Guatemala had not actively monitored this situation so as to detect deficiencies of this type.

Additionally, an official at the Housing Bank, which disbursed about \$4 million in 1986 ESF local currencies in order to finance a low-cost housing project, told us that the Housing Bank does not keep separate controls over this portfolio. These loans were commingled with the bank's other housing loans.

Without proper guidance, the implementing agencies will commingle ESF local currencies with monies from other sources. Therefore neither USAID/Guatemala nor the GOG will be able to track utilization of these funds. It is possible that a substantial amount of ESF money programmed

for 1986 and about \$20,312,030 worth of 1986 funds reprogrammed in 1987 had been commingled with other sources of funds and could not be properly tracked.

Interest on Local Currency - The Housing Bank invested the equivalent of \$4 million from the 1986 ESF agreement in the Bank of Guatemala and other banks in the country. During the period December 1986 through June 1987, the Housing Bank earned \$199,005 in interest.

According to a Housing Bank official, the Housing Bank has no regulations or authorization from the Board of Directors on how the interest generated from the investment of the ESF resources disbursed to the Housing Bank should be used. The official stated that since the \$4 million was disbursed by decree from the Congress of Guatemala these earnings should belong to the Housing Bank and therefore be utilized at its discretion.

Additionally, BANDESA earned \$27,181 in interest from a \$370,370 disbursement made to it from the 1983 ESF local currency agreement. A BANDESA official stated he had never received any instructions on how any interest earned from ESF monies should be utilized. USAID/Guatemala's lack of a monitoring system was a factor in allowing this type of situation to occur. Although both the 1983 and 1986 ESF agreements were silent on the utilization of interest earned, good management practice dictates that any interest earned on programmed ESF monies should be utilized in the same manner and for the same purpose as the originally programmed monies.

Since many other implementing agencies may also be earning interest on programmed ESF monies and not utilizing the funds within the specific activity, the ESF program could be losing a substantial added source of money.

Unexpended Funds - Appropriate monitoring should have detected that about \$5 million worth of local currency generated from the 1986 ESF program was unexpended and available for reassignment.

As of June 1987, the Ministries of Roads and Public Works and the National Institute of Electrification (INDE) had idle ESF funds worth almost \$5 million remaining from the 1986 agreement. According to the Chief of the Financial Department, Ministry of Public Works, as of December 31, 1986, \$106,800 worth of local currency remained in that Ministry from 1986 ESF budgeted monies. At the Ministry of Roads we found that another \$410,000 had not been utilized as of June 1987.

Implementation letter No. 3 for the 1986 ESF agreement states that any portion of the local currencies allocated for 1986 but still unspent by December 1986 will be assigned for projects and activities included in the 1987 government budget as agreed by the Ministry of Public Finance and A.I.D. Officials at the Ministries of Roads and Public Works said they were not aware of this provision. According to the officials, no written guidance had ever been received from the Ministry of Finance.

Additionally, INDE had been programmed the equivalent of over \$4.75 million from the 1986 agreement. According to INDE officials, they had received only about \$299,000 of the total because a Ministry of Finance official had decided to withhold the funds until INDE had repaid a 1982 debt owed to the Ministry of Finance. Based on this action, the equivalent of about \$4.45 million in 1986 ESF funds had not actually left the Central Bank local currency special account, even though the Ministry of Finance had reported to A.I.D. that the equivalent of \$4.1 million had been disbursed.

In total then, almost \$5 million in 1986 unexpended ESF funds was not reassigned as required.

These examples illustrate problems that can arise and remain unresolved when an ESF program is not systematically monitored. Due to the lack of an adequate ESF local currency monitoring system, USAID/Guatemala was not in a position to ensure that the program's goals were being successfully met or that the program's local currency generations were being properly utilized and adequately protected from fraud, waste and abuse.

#### Management Comments

The Mission disagreed with the finding, stating that, "the previous ESF programs for Guatemala had been either small and managed similarly to the PL 480 programs (FY 1983) or projectized (FY 1985). Many of the restrictions and procedures that are now required for ESF programs did not exist in those years. The assertions in the report nearly all relate to the large, multi-year ESF cash transfer program initiated only in mid FY 1986." In addition, the Mission thought the finding was replete with errors and misinterpretations. See Appendix 1, page 3 for the complete text of the Mission's response.

#### Office of Inspector General Comments

We disagreed with the Mission's position because, under Policy Determination No. 5 dated February 22, 1983, which was extended to cover the ESF program in 1984, A.I.D. must monitor the use of the sales proceeds (ESF monies) and assure that they are allocated to support economic development objectives. We interpret these criteria to mean that ESF monies were to be actively monitored. In addition, our audit revealed that the Mission Order establishing monitoring responsibilities was not being implemented. See Appendix 2, points 5-16, for a detailed response keyed to the Mission's comments.

## 2. Attribution of 1986 ESF Dollars Needs To Be Thoroughly Evaluated Prior To Being Found Acceptable

The 1986 ESF agreement held that transferred dollars were to be used to import certain goods from the United States. One half of purchases sampled were from ineligible sources or lacked proper documentation. USAID/Guatemala did not provide adequate purchasing criteria or guidance to the designated Guatemalan monitoring agency. As a result, at least \$1.8 million in ESF monies were attributed to purchases not eligible under the ESF agreement.

### Recommendation No. 5

We recommend that USAID/Guatemala:

- a. not certify the 1986 Economic Support Fund commodity listing of \$47,350,000 until the Controller's office has conducted a thorough evaluation of the Bank of Guatemala's records regarding this program and, where necessary, direct the Bank to make the adjustments in order to bring the commodity listing into accordance with the criteria set out in the 1986 agreement; and
- b. assist the Bank of Guatemala in developing a data system in order to make a proper attribution of the dollars made available under the program. USAID/Guatemala should provide documentation of work done showing that transactions were accounted for in accordance with Economic Support Fund agreements.

### Discussion

According to Article VI (Special Covenants) Section 6.1 of the 1986 ESF Agreement the Borrower/Grantee covenanted:

- a. to make available \$47,350,000 during the twelve months following the disbursement of the cash transfer for the importation from the United States of raw materials, construction materials, intermediate goods, capital equipment and spare parts for the Guatemalan private sector, excluding pesticides; and
- b. within fourteen months following the last disbursements of the assistance, the Bank of Guatemala, based on its computerized records, will furnish to A.I.D., in form and substance satisfactory to A.I.D., evidence which indicates that \$47,350,000 worth of eligible commodities have been imported by the private sector for use in the subsectors set forth in subsection a) above during the first twelve months following the last disbursement of the cash transfer.

A judgmental sample of 50 transactions of the 1986 ESF dollar commodity list presented by the Bank of Guatemala to USAID/Guatemala disclosed that 25 of the transactions, which amounted to about \$1.8 million, or about 72 percent of the value of the sample chosen, was ineligible or inadequately supported. Nine transactions, amounting to \$725,855 worth of imports, were not of U. S. source/origin. The commodities were imported from Canada, Mexico, Venezuela, Chile, Germany, Italy and Holland. In addition, 16 transactions, amounting to \$1,073,760, did not have sufficient supporting documentation. The missing supporting documentation included bills of lading, commercial invoices, and evidence that letters of credit had been paid.

USAID/Guatemala did not provide the Bank of Guatemala with guidance to determine the back-up documentation that was necessary to verify that an imported commodity was eligible under the agreement. Additionally, the Bank of Guatemala did not receive guidance from USAID/Guatemala as to whether commodity eligibility was based on where payment for a product was sent or the origin of a commodity. Due to the lack of guidance, the Bank utilized a flawed methodology in compiling the commodity list; the product was not checked for source/origin but only whether the payment was made to a bank in the United States. Since many foreign companies have bank accounts in the U. S., the Bank of Guatemala's methodology for establishing the commodity list was an unreliable indication of source.

In an April 24, 1987 memo, the Mission Director instructed the Mission Controller to meet with Bank of Guatemala officials to set up guidelines for the dollar reporting and attribution under the 1986 ESF agreement. The Mission Director specifically stated "I would like to get a jump on this item so as to avoid problems when they actually have to submit their reports." Based on our work and conversations with Bank officials, the proper guidance was not forwarded to the Bank of Guatemala by the Controller's office.

Therefore, USAID/Guatemala could not rely on the commodity listing provided by the Bank of Guatemala to ensure that the 1986 ESF agreement's \$47,350,000 had been attributed in accordance with the criteria set out in the 1986 agreement.

#### Management Comments

The Mission stated the document the audit team referred to was a preliminary attribution list obtained prematurely at the auditors' insistence. It was never formally submitted to the A.I.D. Mission. The list formally submitted by the Bank of Guatemala only showed a two-percent rate of erroneous entries. See Appendix 1, page 9 for the full text of the Mission response.

#### Office of the Inspector General's Comments

The Inspector General has not received any documentation from USAID/Guatemala in support of its position. Therefore it stands by the finding and recommendation. See Appendix 2, points 17 and 18 for a detailed rebuttal.

### 3. The Government of Guatemala Had Not Audited the ESF Local Currency Monies

Under the 1986 and 1987 ESF agreements, the GOG was to audit disbursements for ESF local currency fund activities. The GOG had not audited these activities. The GOG agency responsible for auditing these monies claimed it did not have the capability to perform this function. As a result, the \$113.35 million in local currency generated through ESF dollar cash transfers had not been adequately safeguarded and program results could not be properly evaluated.

#### Recommendation No. 6

We recommend that USAID/Guatemala obtain from the Guatemalan Controller's Office an action plan to comply with its auditing responsibilities as laid out in the 1986/87 agreements. This may entail providing local currency resources to hire more personnel, providing proper training and aiding the Government of Guatemala in developing adequate auditing standards or even augmenting the capability of the Guatemalan Controller's office through the use of local CPA firms.

#### Discussion

According to both the 1986 and 1987 ESF agreement, the Guatemalan Controller's Office (Contraloria de Cuentas), in its role as fiscal agent for the Borrower/Grantee, conducts audits of the disbursements for local currency fund activities and subactivities. Such audits will include, in so far as possible, review of records of purchases of goods and services by each agency which implements subactivities under the local currency funds. Upon their completion, audit reports will be furnished to the Ministry of Finance and to A.I.D. A schedule of required audits will be developed by the Borrower/Grantee. According to the USAID/Guatemala Controller, the Contraloria de Cuentas had not done a single audit on the ESF Program.

He was told by the Controller General, head of the Contraloria de Cuentas, that the Contraloria was not capable of complying with the ESF agreement requirements because it lacked sufficient or properly trained staff and inadequate auditing standards from which to audit the ESF programs. The Controller did point out that the Contraloria does pre-audit all payments by the implementing agencies as a control. The audit team was not able to interview the Controller General because the Contraloria de Cuentas personnel were on strike against the Government of Guatemala at the time of the audit.

Since no audits had been conducted by the Government of Guatemala the \$113.35 million in local currency assets were not adequately safeguarded from fraud, waste and abuse and program results could not be properly evaluated.

Management Comments

The Mission said the finding's recommendation needed to be changed to make it implementable. See Appendix 1, page 11 for the complete text of the Mission response.

Office of Inspector General Comments

An appropriate change was made. See Appendix 2, points 21-22 for a detailed response to the Mission comments.

## B. Compliance and Internal Controls

### Compliance

The audit disclosed four compliance exceptions. First, GOG implementing agencies were not depositing local currency into separate bank accounts so that the funds were trackable and not commingled as directed by the House Appropriations Committee (Finding 1). Second, under the 1986 ESF agreement, Implementation Letter No. 3 states that any portion of the local currencies allocated for project activities selected for 1986 but still unspent by December 1986 will be assigned to projects and activities included in the 1987 government budget agreed by the Ministry of Public Finance and A.I.D. As of June 1987, the Ministries of Roads, and Public Works and the National Institute of Electrification had idle ESF funds worth almost \$5 million remaining from the 1986 agreement (Finding 1).

In addition, the 1986 ESF agreement held that the dollars provided were to be attributed to import certain goods from the United States and proper documentation was to be made available as evidence. A judgmental sample of 50 transactions of the 1986 dollar commodity list presented by the Bank of Guatemala to USAID/Guatemala revealed that 25 of 50 1986 transactions sampled (72 percent of the value or about \$1.8 million) came from ineligible sources or lacked documentation (Finding 2). Finally, the GOG was not auditing the ESF program as required under the agreements (Finding 3).

### Internal Controls

The audit disclosed one internal control exception. USAID/Guatemala had not implemented a monitoring system in order to safeguard ESF assets as required by Policy Determination No. 5 (Finding 1).

### C. Other Pertinent Matters

Six other issues were identified during the audit.

First, the Bank of Guatemala invested \$40 million of the 1986 ESF tranche in short-term investments in commercial banks. The bank's actions were based on the fact that the ESF dollars were deposited into their general account and not a special account and the 1986 ESF agreement was silent on the subject of interest generation. From June through December 1986 the Bank of Guatemala earned \$646,027.00. Although we agree with the Mission that any interest earned on the dollar account held abroad fulfills the program's objectives of strengthening Guatemala's foreign exchange reserve position, we believe that these vital dollars should be utilized and not held idly in commercial accounts gathering interest.

Second, According to the 1983 ESF program agreement, the local currency equivalent of \$10 million should have been disbursed for AID and GOG approved projects within two years from the date of approval of the local currency fund implementation plan, or by December 29, 1985. However, as of May 31, 1987, the equivalent of \$1,058,000 earmarked for BANDESA had not been expended. The disposition of these funds need to be jointly reviewed by A.I.D. and the GOG.

Third, on April 29, 1987 a memorandum from the Department of Treasury expressed a legal opinion that A.I.D. local currency trust fund monies could be deposited into an interest-bearing account. The money was not placed into an interest-bearing account in the past because the Treasury Department had not indicated that it was permissible. ESF funds to defray administrative expenses were deposited into a non-interest-bearing account at the Bank of America in the name of the U.S. Disbursing Officer (USDO). The account held the equivalent of \$2.96 million as of June 15, 1987. Based on an 11 percent per annum interest rate, an interest-bearing trust fund account could generate about \$27,000 in local currency equivalent per month. The interest would be utilized for the same purpose as the originally programmed monies.

Fourth, USAID/Guatemala's files were incomplete with respect to the administration of ESF program activities. There was confusion in the Mission as to which office was responsible for maintaining the ESF program records. Therefore, USAID/Guatemala was not able to provide appropriate management oversight over ESF program activities.

Fifth, the 1986 ESF agreement stated that the Borrower/Grantee would deposit into a special account in the Bank of Guatemala the local currency equivalent of U. S. dollar disbursements made under this agreement. The local currency equivalent of each U. S. dollar disbursement would be calculated by using the highest rate of exchange which, on the date of the dollar disbursement, was not unlawful in Guatemala. The Government of Guatemala deposited the 1986 ESF \$47.35 million local currency equivalent into the special account within the Bank of Guatemala at a weighted average rate of Q2.84407 = \$1.00 rather

than the highest lawful rate of Q2.97541 = \$1.00. This methodology was subsequently approved by the LAC Bureau.

According to a Mission official, this action did not receive A.I.D./Washington approval. However the Mission considered use of this rate fully in line with Bureau guidance. There was nothing to be found in the ESF agreement to indicate that the Mission had the authority to unilaterally decide not to use the exchange rate criterion provided in the agreement. Therefore the Government of Guatemala deposited Q6,218,950 less into the 1986 ESF local currency special account. At the August, 1987 exchange rate of Q2.70 = \$1.00 the shortfall amounted to about \$2.3 million.

Sixth, we noted that the 1986 ESF Program Assistance Approval Document (PAAD) contained a covenant providing for an annual audit of financial and program activity to be performed by an A.I.D.-approved independent public accounting firm. This was added while the document was in Washington. There was no indication as to when the Mission was advised of this change, apparently, however, the ESF agreement was signed prior to the return of the PAAD from Washington. Good management practice would dictate that an ESF agreement should not be signed prior to Washington approval of the program PAAD. Therefore an important oversight tool to help protect the 1986 ESF program assets of \$47.35 million from fraud, waste and abuse was not included in the agreement.

See Appendix 1, pages 10, 11, 12, and 13 for the Mission's comments on this section.

For detailed response to the Mission comments see Appendix 2, points 19, 20, 23-26.

AUDIT OF  
USAID/GUATEMALA  
ESF PROGRAM

PART III - EXHIBIT AND APPENDICES

SAMPLE OF 1986 DOLLAR TRANSACTIONS TESTED

EXHIBIT I

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Page 1 of 3

Transactions	Bill of Lading	Commercial Invoice	Eligible Commodities \$ US	Ineligible Commodities \$ US	Comments
1	-	-	---	192,450.00	Incomplete documentation.
2	-	-	---	9,000.00	Incomplete documentation.
3	-	00219	---	6,955.00	Incomplete documentation.
4	3096/97/98	3123	32,915.25	---	
5	-	-	---	6,930.00	Incomplete documentation.
6	YST0400016	94428	38,675.00	---	
7	FMC160	5336	14,363.14	---	
8	00264	01196	187,885.85	---	
9	T Parker-4	01135	6,698.00	---	
10	MGT-042-00-6	2011	6,247.80	---	
11	CAAG0700915	48294	10,610.60	---	
12	FMC #656	2527	6,065.62	---	
13	7	7235	11,100.00	---	
14	CCT-97	28320	32,745.52	---	
15	-	-	---	115,500.00	Incomplete documentation.
16	784-734565-3	50006498	12,945.83	---	
17	-	-	---	14,225.00	Commodities imported from Mexico incomplete documentation.
18	ST-108840	502101	43,762.20	---	

SAMPLE OF 1986 DOLLAR TRANSACTIONS TESTED

EXHIBIT 1

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Page 2 of 3

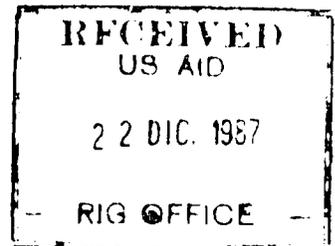
Transactions	Bill of Lading	Commercial Invoice	Eligible Commodities \$ US	Ineligible Commodities \$ US	Comments
19	-	-	---	9,300.00	Commodities imported from Canada.
20	-	-	---	615,000.00	Incomplete documentation no evidence of payment of letter of credit.
21	-	00247	---	18,000.00	Incomplete documentation.
22	562541	00210	17,500.00	---	
23	-	-	---	10,367.85	Incomplete documentation.
24	COALS4-ARMAGUAE	0056610A	11,800.00	---	
25	-	-	---	20,059.00	Incomplete documentation.
26	INC-6	CI-ATO1825	75,813.80	---	
27	EMP303965E	860736	7,286.13	---	
28	HET-036-004-A	2933	7,697.67	---	
29	E-61500 (65)	187155-9	27,540.00	---	
30	00561	00183	5,150.00	---	
31	784734369-E	E-4136E	---	28,050.59	Commodities imported from Canada.
32	031007207	056-00065500	25,851.65	---	
33	784735544e	056-0007361	---	53,030.70	Commodities imported from Canada.
34	N L	1637812	26,800.00	---	
35	HOU-30771	0560005752	26,850.60	---	
36	N L	5070	---	16,920.47	Documentation only shows \$13,126.47 amount of transaction.

SAMPLE OF 1986 DOLLAR TRANSACTIONS TESTED

EXHIBIT 1

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Page 3 of 3

Transactions	Bill of Lading	Commercial Invoice	Eligible Commodities \$ US	Ineligible Commodities \$ US	Comments
37	003	000382	---	90,609.10	Commodities imported from Venezuela.
38	-	0015	---	145,114.00	Commodities imported from Chile.
39	-	-	---	316,000.00	Commodities imported from Holland.
40	SIT 9	860045526	---	54,426.36	Commodities imported from Federal Republic of Germany.
41	2723	006044	---	5,345.46	Documentation only shows \$2,349.26 as amount of transaction.
42	PER-305640	14153/305820 610/630/640	19,688.71	---	
43	-	-	---	15,099.65	Commodities imported from Italy.
44	MO-23269	739631	7,698.72	---	
45	Seaboard	421115	---	9,042.71	Documentation only shows \$6,457.71 as amount of transaction.
46	HST-043-001C	LX3625	21,773.39	---	
47	86318	1336-90878	---	6,080.20	
48	-	-	---	27,540.00	Documentation not available.
49	-	-	---	5,700.00	Documentation not available.
50	-	-	---	8,868.40	Documentation not available.
Totals			----- 689,738.54 -----	----- 1,799,614.53 -----	



UNITED STATES GOVERNMENT

# Memorandum

TO : Coinage Gothard, RIG/T/A

DATE: Dec. 18, 1987

FROM : Anthony J. Caputo, Director  
USAID/Guatemala

SUBJECT: RESPONSE TO DRAFT AUDIT REPORT ON USAID/GUATEMALA ESF PROGRAM

In my many years of AID service, I cannot recall a more unpleasant task than preparation of the Mission response to the subject audit report. Frankly, I was stunned by a report that was so replete with observable errors of fact, illogical inferences, ignorance of AID programs, and omissions of critical information. In my past experience, I have never had reason to question the good faith of the auditors, even when I disagreed with their findings. However, in this case, the subject report is so demonstrably wrong, both in its specific content and in its tone and inferences, that it approaches outright misrepresentation. As you might imagine, I find little basis to prefer one of these over the other.

In the Executive Summary as well as throughout the report, false statements are made about USAID/Guatemala monitoring of the ESF program, certification of PVO recipients, reporting, commingling of funds, and dollar attributions for the FY 1986 program. Misleading statements are made about dollar-generated interest. USAID/Guatemala personnel are frequently misquoted or pertinent information which the Mission provided to them is left out. And throughout the report, the author(s) use frequent repetition of unsubstantiated assertions as a substitute for documented evidence that the assertions are true.

These flaws in the report are present despite literally dozens upon dozens of hours of my staff's scarce time spent in attempting to set the record straight with the audit team. Most of the corrections that I will cite in this memo to false or misleading statements contained in your report have already been given, in some cases repeatedly, to staff.

[1] I would like to again reiterate that the previous ESF programs for Guatemala had been either small and managed similarly to the PL 480 programs (FY 1983) or projectized (FY 1985). Many of the restrictions and procedures that are now required for ESF programs did not exist in those years. The assertions in your report nearly all relate to the large, multi-year ESF cash transfer program initiated only in mid FY 1986.



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The above distinction is important because in Guatemala, the true initiation date of the large, policy-based ESF cash transfer program was that of the FY 1986 disbursement - June 6, 1986. The audit began less than a year after the program started. In many cases, the audit staff were literally waiting by the "in box" for reports and communications to arrive. In some cases (documented below), they even exceeded their mandate as auditors to interfere with the on-going project implementation process. The audit team accuses the Mission of not having mechanisms in place and not preparing or reviewing reports, when in fact in many cases it was just too early for procedures to be operational.

[ ] Furthermore, there is no balance in the report. The audit is essentially silent on the impact of the program on the economy of Guatemala. The objectives of the program as stated in the PAAD were:

--to restore Guatemala to a path of positive economic growth;

--to support the adoption of politically difficult fiscal, monetary and exchange measures;

--to encourage the substitution of domestic savings for external borrowing;

--to promote greater public support to the process of economic growth and development, particularly in rural areas where a situation of social injustice is manifestly evident; and,

--to assist the Government of Guatemala's support of the private sector, and particularly the export sector.

Those objectives have demonstratively been achieved and the Guatemala ESF program is recognized as the best in Central America and one of the best anywhere. To ignore these accomplishments is a disservice to the Agency, USAID/Guatemala and the GOG.

[ ] I believe that, despite staff shortages amid a rapidly growing workload, the USAID/Guatemala staff members are effective managers. They have made sound judgments in response to changing in-country political circumstances, congressional mandates and AID policies. The draft audit report you have produced leads the reader to believe otherwise, and must be corrected.

- 3 -

Background Statement:

- [4] The opening tone of the report misrepresents the reasons for which the U.S. government decided to initiate a large ESF cash transfer program in Guatemala in FY 1986. At that time, Guatemala had a newly democratically elected civilian government, the first in 30 years. Moreover, the new administration entered with a serious commitment to economic policy reform. Had these factors not been present, there would not have been large ESF cash transfer programs in 1986 and FY 1987. The program purpose and goals are clearly described in the PAADs for FY 1986 and FY 1987 (which we gave to the audit team), but are ignored in the audit report's background information on the programs.

Response to Specific Findings:

In the sections which follow, I will address each finding. I will point out places where the audit report author(s) make errors, misinterpretations, and faulty conclusions.

Finding Number 1:

- [5] Under the discussion section Finding No. 1, the audit team states that the "Guatemalan local currency funds were not covered by monitoring system or individual oversight." The statement is false.

Local currency funds associated with the FY 1986 ESF program began to be utilized in the last three months of CY 1986. At that time, the Mission began receiving and reviewing the quarterly reports of disbursements of LC funds to implementing agencies--reports that were required in the ESF agreement. We formalized and strengthened this system with the adoption of Mission Order No. 19.3 on April 7, 1987. Mission staff put into place the programming and monitoring system described in the Mission Order over the following few months.

- [6] The Auditors' evidence that the system was not in place includes the charge on page 9 that "no member of USAID/Guatemala Controller's Office had ever conducted a financial evaluation in order to evaluate the local currency uses under the ESF program." This charge is unreasonable, given that financial reviews are conducted after the fact, and at the time of the audit, funds had just begun to flow into activities. The auditors should appreciate "post-audit concepts." The Mission will begin appropriate financial reviews after the end of the Guatemalan 1987 fiscal year (January 1 to December 31, 1987), as this will give us at least a full year of financial flows of ESF-generated local currency to evaluate. (This false statement is repeated on pages 5, 7, 9, and 10.)

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- [7] The auditors misquote the USAID Controller in the same discussion on page 10. The draft report states that "In the opinion of the USAID/Guatemala Controller, USAID/Guatemala had no monitoring responsibilities . . ." This is not what the Controller told the audit team. He stated that the USAID/Controller had limited local currency monitoring responsibilities over the ESF program prior to my arrival in August (not November) of 1986. He also informed the audit team that in November of 1986 I asked him to draft a Memorandum Order establishing a programming and monitoring system which would imply more substantial Controller involvement. The previous low level of Controller monitoring responsibilities was fully consistent with AID and Mission policy and existing legislative responsibilities. The auditors should distinguish between the various different AID policies in effect at the time the FY 1986 and 1987 agreements were signed. (This misquote is repeated on pages 7 and 10.)
- [8] The auditors further state in the same section (page 10) that, "Due to the lack of an adequate ESF local currency monitoring system, USAID/Guatemala was not in a position to detect and resolve problems with the program. For example, private sector recipients were not certified." In this case, your staff chose to ignore the information we gave them that, both at the time of the audit and to date, no agreements providing local currencies have been signed and no local currency funds slated for the private sector have been released. (The FY 1986 ESF agreement provided no local currencies for programs with the private sector. Such funds were first included under the FY 1987 agreement signed April 13, 1987.) In accordance with our implementation schedule, a pre-award survey for the PED project is now underway under the RIG/T/A non-federal audit program. The associated agreement will eventually be the first obligation of local currencies for a private sector program. Since the PED project grantee is not a PVO, certification/registration is not formally required, but we are conducting the survey as a management tool. We will carry out other required surveys before the agreements are signed. (The audit team repeated this false statement on pages 5 and 10.)
- [9] My staff told the auditors that most of the ESF program goals relate to macroeconomic policy. The audit report is generally silent on the issue of Mission monitoring of these goals, but it contains a confused discussion and erroneous recommendations about one important area of policy--fiscal management--for which local currency programming is an important tool of the ESF program.

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- [10] Due to the high inflation Guatemala was experiencing in 1986, and due to insufficient public investment in development infrastructure, most local currency has been provided as general budget support. In other words, LC is programmed to advance funds to or reimburse the government for activities it undertakes in areas supportive of AID's development interests in Guatemala. LC programming is also carried out in a way consistent with overall monetary goals, which include limits on internal financing of the deficit. This latter concern is in conflict with the auditors' stated belief that all local currencies should be expended in the same year as program obligation. In any event, that all local currencies be expended quickly is neither a requirement of the ESF program nor a condition of our ESF agreements which stipulate a three-year period for utilization. Given the above, your recommendation that "USAID/Guatemala obtain evidence that the Ministry of Finance has reprogrammed all . . . 1986 Economic Support Funds (local currency) that have not been expended" is incomprehensible.

This statement demonstrates a basic lack of understanding by the auditors of fiscal management. The suggestion is analogous to requiring that an AID Mission deobligate its pipeline (unspent or idle funds) at the end of the fiscal year and reprogram it into a different set of activities. Funds lie idle because of implementation delays. What is important to USAID/Guatemala is that the local currency reports correctly reflect expenditure rates and passage of unexpended balances at the end of the fiscal year into the same project for the following year, and that monies are reprogrammed promptly after a decision to terminate a project has been taken. The language in Implementation Letter No. 3 states this concept. (The audit report author(s) repeat this misconception on pages 15-16, and on page 32.)

- [11] The examples and concepts referred to above generally relate to normal project pipelines. One case cited in the audit report--the local currency allocated to INDE--has a different history. On page 16 of the report, your staff states that Ministry of Finance officials withheld ESF funds assigned to INDE until INDE repaid a 1982 debt owed to the Ministry. The figures given in the report are correct. The explanation is incorrect.

The Ministry of Finance processed the allocation of funds to INDE fully, such that the paper trail showed payment actions to the point of a check being printed for INDE. At the last minute, a high level decision was made in Finance to reverse the decision to provide funds to INDE, since Finance had recently paid INDE for a debt of the Guatemalan water utility (EMPAGUA), with the result

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that INDE had sufficient funds to carry out the local currency activity approved. The Ministry did not inform the Mission of this decision until September 17, 1987, in its request that the funds be reprogrammed.

We appreciate that the Ministry of Finance should have moved faster to request approval for reprogramming of the funds from the AID Mission. However, the reporting available to the Mission showed that payment to INDE had been fully executed.

- [12] The audit team states on page 10 that, "Discussions with several USAID/Guatemala project managers revealed that none were actively monitoring the use of local currency within their projects." I assume you mean ESF local currencies, given the context of the finding under which this criticism falls. Further, on page 11, the audit team asserts that, "Neither the Controller's Office, and/or Program Office nor the Project Development Support Office could inform the auditors how much ESF local currency had been programmed as local currency counterpart for AID projects, or for which projects." The first statement is misleading, while the second is plainly false.

For the first assertion, your team does not mention that few ESF local currencies have been used as project counterpart because most of these needs were being covered with PL 480 funds at the time of the audit. The Ministry of Finance reported that in CY 1986 there were only two AID projects whose counterpart needs were covered with ESF local currencies (by now, there are several more). The audit team chose a few project managers in the AID Mission at random to ask about ESF local currency used as counterpart. It is not surprising that the project managers they asked did not know about ESF counterpart used in their projects, since in all likelihood there was none.

It has been a long standing policy of this Mission that it is the project managers responsibility to assure that his counterpart agency in the GOG request adequate counterpart funding through the normal GOG budgetary process. The project manager is not likely to know or care what the source of the funds are, nor is he required to know. When funds for counterpart are from ESF generated local currencies, the USAID Program Office is the key office for the joint programming of the local currency.

- [13] The second statement (repeated on page 11) is false. As to the second statement, the Deputy Program Officer provided the audit team with a Program Office report commissioned to identify donor projects within the public sector budget. That exercise looked at use of ESF local currency for AID project counterpart.

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In your report on page 11, the author(s) choose to elevate a memo from the Mission Director to the Controller to the status of a smoking gun. They quote the memo as follows:

- [14] "Faulty Reporting - A good example of the importance of a monitoring system was brought out in an April 24, 1987 memorandum from the Mission Director to the Controller entitled 'ESF Local Currency and Dollar Tracking.' According to the memo, a Mission staffer informed the Director of a number of inconsistencies and errors in the ESF local currency reports the Mission received from the Ministry of Finance. In addition there was some confusion caused by the reprogramming of 1986 undisbursed local currency into the 1987 budget. The Mission Director directed that this faulty reporting be cleared up with the Ministry of Finance and that the reports be reconciled so that local currency utilization could be adequately tracked."

The auditors members assert that the Mission did not address the problems identified with the local currency reports despite the directive contained in the above memo. Not only is this statement false, but the audit team omitted information we gave them on our follow-up to the memo. The statement is repeated four times, on pages 7, 11, 12, and 20.

The problems cited in the memo related to the reconciliation of the report for the first quarter of 1987 with the report for the last quarter of 1986. These two reports were the first received by USAID, since few local currencies had been expended prior to September of 1986. Mission staff found the first report sent by Finance to be acceptable. However, the second report, sent to us in April of 1987, was difficult to reconcile due to its format. This problem prompted the memo. The first problem with the local currency reports surfaced only in April of 1987.

Following the memo's delivery to the Controller, the Director chaired a meeting attended by the Deputy Director, the Program Officer, the Economic Officer and the Controller. In this meeting, Mission staff discussed the problems brought out in the memo and decided to raise the issue with the Ministry of Finance. At the same meeting, we determined that reporting issues would be brought up for the FY 1987 ESF programs as early as possible to ensure compatibility with the FY 1986 program. At this meeting, the Controller returned the memo to the Director, which is why there was no copy in the Controller's files, or his memory. I do not see any significance in the Controller's inability to remember a memo the moment your staff member presented it to him given the thousands of documents contained in USAID files.

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Mission staff followed up with proper actions. The Program Office arranged a meeting held at the Ministry of Finance on June 19, 1987. Attending the meeting were the Deputy Program Officer and the Economics Officer from USAID, and the Chief and two staff members of the Division of External Finance. At the meeting, USAID asked that the ESF LC reports be presented in a similar format to that of the PL 480 reports.

Finance's position was that they could not make these changes due to their lack of personnel. USAID recommended that ESF local currencies be used to fund the additional staff they needed. Accordingly, Finance submitted a request for ESF funding of additional staff for the local currency unit in August. USAID approved this request in PIL No. 12 dated September 29, 1987. The additional staff is now in place, and the quality of the reports is much improved.

[15] Your staff members assert on page 12 that "funds" generated under the program "were comingled." This is not true. Local currencies generated under the program were deposited into a special account as required under the agreement, AID legislation and AID/V guidance. They are "trackable" under the GOG budget process. ESF local currencies are allocated by the GOG under their normal budgeting process. In their budget, the GOG clearly identifies the source of funds (e.g., PL 480, DA, ESF ) as well as the use. Apparently, your staff did not verify this, even though Mission personnel explained the procedure to them several times. It is completely within AID regulations and policies that monies generated under the ESF program be allocated and disbursed according to host country procedures. In fact, it would be contrary to good development assistance policy to do otherwise. (Your staff members repeat these false statements five times, on pages 5, 7, 12, 13 and 32.)

[16] The author(s) try to clarify their point on pages 14 and 15 in their statement, "Since many other implementing agencies may also be earning interest on programmed ESF monies and not utilizing the funds within the specific activity, the ESF program could be losing a substantial added source of money. As an indication, the entire utilized 1986 tranche of \$30,027,125 would have earned the equivalent of \$1,501,350 per year at five percent interest."

This statement is misleading and an exaggeration. LC under the ESF program are primarily used for infrastructure, not for credit programs, as was evident from our records. BANDESA and the Housing Bank are the only two credit institutions thus far which have received local currency funds from the ESF program. The audit report, and its exaggerated calculations suggest that there are balances of local currency lying around in all implementing institutions drawing interest.

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The fact is that except for the two credit institutions, other implementing agencies receive local currency from the special account in the Central Bank through a system of purchase and payment orders. No advances are given within the Guatemala system, except for petty cash. Hence, this vast amount of local interest they allude to just does not exist. Your staff discussion in this section suggests a lack of knowledge in how local currencies flow to implementing agencies.

Furthermore, our purpose in approving use of local currencies and support to financial institutions such as BANDESA and the Housing Bank is to strengthen them, in the interest of development in Guatemala. Since the support is general, use of local currencies generated interest by these institutions fulfills the same general purpose as the original allocation of the principal, in our view.

In summary, I believe that all discussions, references and recommendations relating to our responses to finding No. 1 should be deleted from the report. I further request that, for any such discussion, reference or recommendation not removed from the report, the USAID/Guatemala response contained in this memo be included, verbatim, immediately following the relevant text, and the text is repeated.

Finding No. 2:

- [17] On page 19, the auditors state that a "systematic sample of transactions of the 1986 ESF dollar commodity list presented by the Bank of Guatemala to USAID disclosed that" numerous errors existed. This is an example of the audit team's interference with project implementation. The team visited the Central Bank prior to the due date established in the agreement (August 14, 1987) for delivery of the list, and pressured for the list's production. At the same time, the Mission through other channels was conveying the message that the list should not be submitted until the issue separating FY 1986 program eligible transactions from FY 1987 eligible transactions was resolved. (USAID ended up formally extending the period for receipt of the 1986 list to December 1987, in order to allow the Central Bank time to revise the procedures in accordance to some changes needed to make the FY 1987 separate dollar account functional).
- [18] The document the audit team refer to was a preliminary list obtained at their insistence. It was never formally submitted to the AID Mission. The systematic sample drawn from this list was not a random sample, and should not be cited as proof that the dollar attribution was faulty. In fact, the random sample audit of the lists we have formally received thus far for attribution of the ESF dollars showed only a two-percent rate of erroneous entries.

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USAID/Guatemala believes that the provisions contained in the 1986 ESF agreement for dollar attribution are adequate. I urge that all references, discussions and recommendations relating to the text above be deleted from your report. Alternatively, I ask that USAID/Guatemala comments stated above be repeated verbatim following the relevant text of the report, each time the assertion are repeated. Furthermore, I note the unprofessional manner in which the audit team acted in insisting on the list before the BC was ready to provide it. In doing so, they interfered in the normal monitoring of the program by the Mission. They intrude into GOG/Mission discussions about the preparation of the document before the submission date established in the agreement.

Finding No. 3: [Has been moved to other pertinent matters]

- [19] In Finding No. 3 on page 22, your staff members state that, "This interest (on the 1986 ESF dollar disbursement) . . . should be utilized for program purposes." "We recommend that USAID/Guatemala . . . direct the Bank of Guatemala to utilize for Economic Support Fund purposes the . . . interest earned on 1986 ESF monies. In addition, USAID/Guatemala should determine if any more interest was earned after December 1986."

This recommendation strains credibility. The PAAD justification for the FY 1986 ESF dollar disbursement was to help Guatemala achieve the program objective (quoted on page 2 of this memorandum by strengthening Guatemala's foreign exchange reserve position. By definition, any interest earned on the dollar accounts held abroad fulfills the program objectives.

More disturbing is the audit team's belief that AID can calculate the amount of interest earned on a disbursement into a government's general reserves, in the absence of a separate account. We know that the auditors went to great lengths to make such a calculation but it is spurious given the fungibility of liquid assets. This is precisely why there are no provisions in the 1986 agreement for interest earnings - without a separate account it makes little sense. (These misleading statements are repeated on page 5).

The report language is sloppy in implying that all ESF agreements for Guatemala are silent on treatment of interest. In fact, with the separate dollar account,--required by Congress for the first time in FY 1987-- tracking of interest is feasible, and appropriate provisions are contained in the FY 1987 agreement.

The Mission response you quote is to a different recommendation your team made in an earlier version of the report (that the interest earned on the 1986 dollar disbursement be returned to the U.S. Treasury). Since you reversed your finding, citing the previous Mission response is misleading.

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I request that all references, discussions and recommendations the issues cited above be removed from the audit report. If they are not removed, then I request that Mission comments be repeated verbatim, alongside the relevant text each time it appears in the report.

Finding No. 4: [Has been moved to other pertinent matters]

- [20] As discussed on pages 27 and 28, the Mission has established, in conjunction with RAMC/Mexico, an interest-bearing account for Trust Funds and a system for accounting any interest earned. However, the audit team is in error in the calculation of interest to be earned. None of the program local currency private sector programs has been deposited into the USDO account since the agreements have not been signed and funds are not needed. Furthermore, the GOG will make the deposits for the projects annually according to estimated expenditures rates. This procedure avoids excessive monetization of the funds consistent with monetary policy goals.

I ask that the interest calculation be deleted from the report. Alternatively, I request that the text above be included, verbatim as the Mission response to Finding No. 4.

Finding No. 5: [New Finding No. 3]

- [21] On page 29, the report author(s) discuss the shortcomings, which the Mission staff pointed out to them, of the Government of Guatemala Controller General Office. The audit team did not investigate the issue of GOG audit of local currency programs further. However, the excuse that "The audit team was not able to interview the Controller General because the Controlaria de Cuentas personnel were on strike against the Government of Guatemala at the time of the audit" is false.

The Controller General Office was on strike from July 11 to July 31, or 15 work days. The audit team fieldwork was conducted in Guatemala from May 18 through August 28, 1987.

According to these dates, there was ample opportunity for the audit team to visit the Controller General Office. The audit team chose not to avail themselves of this opportunity, as it is obvious that the Controller General Office was not on strike the entire period of the audit. In not interviewing the Controller General and his staff, the auditors missed an important opportunity to provide an independent evaluation of the GOG's capability to evaluate the local currency program, and to document any activities they had underway or plan for the future in this area.

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- [22] Furthermore, Recommendation Number 8 (page 29) needs to be changed to make it implementable. As written, it would take several years to implement. We cannot, at this time or in the near future, "ensure that the Guatemalan Controller's Office develop an action plan in order to comply with its auditing responsibilities." If this is not a matter the Mission can control, we are currently developing a project to assist them. In the meantime, we must rely on the Mission's ESF-financed audit trust fund to fill the bill.

I request that you include the paragraphs above, verbatim, as the Mission response to Audit Finding No. 5.

Other Pertinent Matters:

- [23] A. On page 34, the audit team states that, "USAID/Guatemala's files were incomplete with respect to the administration of ESF program activities" and that, "There was confusion in the Mission as to what office was responsible for maintaining the ESF program records."

Mission staff told the auditors emphatically and repeatedly that the official files were maintained by PDSO.

Unless your office can support the assertion that files were incomplete with a list of missing documents, it should be deleted from the report. I further request that the paragraph above be listed as the Mission response to the first pertinent matter, verbatim, unless the assertion about "Mission confusion" is removed.

- [24] B. The exchange rate used in FY 1986 was based on considered Mission interpretation of the existing guidance. We chose the weighted average rate due to the disorder which prevailed in the exchange markets on the date of disbursement, which made the highest (spot) rate difficult to determine.

Reference to the Mission Economist should be removed since the statement reflects the position of the Mission. In addition, the language suggests that AID/Washington disapproved the exchange rate used. This was not the case. The guidance requires AID/W approval of exceptions, not of all applications of its concepts. The Mission believed that the exchange rate used was a correct interpretation of the guidance given the circumstances in the exchange market on the date of disbursement, and therefore did not seek AID/W approval.

I request that you cite the language above verbatim as the Mission

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response to the second pertinent matter.

C. On page 34, the audit report author(s) state:

"The ESF Agreement was signed prior to the return of the PAAD from Washington. Good management practice would dictate that an ESF agreement should not be signed prior to Washington approval of the program PAAD. . . . Therefore, an important oversight tool to help protect the 1986 ESF program from fraud, waste and abuse was not included in the agreement."

The issue referenced above arose from an editing change to the PAAD that occurred sometime between its approval at the DAEC and its final printed copy. The Mission prepared the ESF agreement working from the PAAD submitted to and approved by Washington and the authorization which is the most important document in the process in that it is the basis for the negotiation of the agreement with the cooperating country. And, the authorization did not contain any language different from that proposed by the mission. The final bound copy has slightly different language about proposed audits of the program. No one in the Mission recalls having made or discussed this change, nor does the issues paper or authorization mention the modification.

[25] In the report, your staff do not explain which important management tool was lost. In fact, the revised language appearing in the bound version of the PAAD provides that audits will be conducted by AID-approved independent public accounting firms. The agreement provides for record review and inspection rights for entities designated by AID (which would include, at our discretion, independent public accounting firms). The difference in language is certainly not "the loss of an important oversight tool to protect program assets from fraud, waste and abuse."

[26] The audit team is confused between the act of authorization of the PAAD by AID/W and the act of the diplomatic pouch delivering the bound copies of the PAAD from the AID/W printing office to the Mission. The first act must clearly precede obligation. To suggest the the second act must also precede obligation is ridiculous. Your recommendation, if followed, would result in untenable delays in obligation of funds since bound copies of PAADs and Project Papers take 3-6 months to arrive from AID/W following authorization.

Our point in citing the delayed arrival of the bound copies was that we were unaware of the editing changes in question at the time we drafted the agreement. The PAAD was signed by the DAA on May 22, 1987. The FY 1986 ESF agreement was signed on June 6, 1987.

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I request that the third pertinent matter be deleted from the report. Otherwise, I request that the Mission response above be repeated, verbatim, alongside the relevant text.

In summary, I expect that your office will revise the audit report to reflect the information provided in this memo. However, if that is not done, I again insist that the Mission comments contained in this memo be inserted verbatim into the body of the report at each and every point where the particular topic is discussed.

OFFICE OF INSPECTOR GENERAL RESPONSE  
TO MANAGEMENT COMMENTS

Responses are keyed to marginal numbers added for reference to the Mission comments.

1. We disagree that many of the procedures that are now required for the ESF program did not exist in 1983 and 1985. As we stated in Finding No. 1, according to Policy Determination No. 5 dated February 22, 1983, A.I.D. must monitor the use of PL 480 sales proceeds and assure that they are allocated to support economic development objectives. In 1984, the A.I.D. Administrator extended the policy to cover Commodity Import Program (CIPs) and cash transfers (ESF Agreements).

The assertion in our draft report was that, as of 1984, USAID/Guatemala was required to have had an active monitoring system in place in order to assure that ESF assets were allocated to support economic development objectives. The large policy-based ESF cash transfer program which was initiated on June 6, 1986 should have been implemented under a pre-existing management/monitoring system.

2. We believe the report adequately answered the audit report objective, which was to determine, in part, if USAID/Guatemala and the Government of Guatemala had established adequate monitoring controls in order to ensure that the ESF assets were adequately safeguarded and utilized for intended purposes.

3. The audit was made in accordance with generally accepted government auditing standards by an experienced, highly-trained audit team. The report for the most part is a clear and accurate picture of how USAID/Guatemala Management is carrying out its responsibilities under the ESF program.

4. Appropriate information was added to the background section.

5. We stand by our statement that Guatemalan local currency funds were not covered by a monitoring system or individual oversight. We interviewed the primary Mission Managers involved with the ESF program: the Controller, Program Officer and Program Development Support Officer. All three stated that their offices were not monitoring ESF resources.

In addition, we disagree that Mission Order No. 19.5 formalized or strengthened any existing monitoring system. In a June 8, 1987 interview, the Project Development and Support Officer stated that Mission Order No. 19.5 dated April 7, 1987 was being redrafted and she was not sure when it would be completed. Subsequently, Mission Order No. 19.7 dated November 23, 1987, revised and superseded Mission Order No. 19.5 dated April 7, 1987.

In addition, in an interview with the Controller dated July 28, 1987 concerning implementation of the Mission Order, he said the monitoring system as proposed under the order had not yet been implemented.

6. We do not find this statement unreasonable considering the fact that the Controller's Office or someone within the Mission should have been doing these type of evaluations since 1984.

7. We beg to differ. The Controller was not misquoted. This statement comes from a July 28, 1987 interview between the Controller and the Auditor-in-Charge which is documented in our workpapers.

8. Appropriate change was made.

9. The report clearly addresses the report's objective, which was to determine if USAID/Guatemala and the Government of Guatemala had established adequate monitoring controls in order to ensure that the ESF assets were adequately safeguarded and utilized for their intended purposes.

10. The report does not make the assertion that all local currencies should be expended in the same year as program obligation. The report simply stated that, under Implementation letter No. 3 for the 1986 ESF agreement, any portion of the local currencies allocated to finance project activities selected for 1986 but still unspent by December 1986 were to be reassigned for projects and activities included in the 1987 government budget, as agreed by the Ministry of Public Finance and AID.

11. We stand by the explanation given in the report. The explanation for the INDE situation was obtained from Licenciado Ricardo A. Palacios, Finance Manager for INDE, in an interview conducted on August 20, 1987. During the interview, Mr. Palacios stated that the Ministry of Finance did not release the programmed ESF funds because of a disagreement over a 1982 debt which involved INDE and other Government agencies. This explanation was further supported through an interview with Licenciado Mario Euben Farfan, Deputy Director, external financing division of the Ministry of Finance, conducted on August 26, 1987. No documentation has been presented that would induce us to alter our position.

12. The Mission's comments do not change the fact that project managers were not given guidance to monitor ESF local currency; therefore a vital oversight/monitoring tool was not being implemented. By the Mission's own admission, at this point in time many AID-supported activities are being financed with ESF local currency.

13. It is true that we obtained the report from the Deputy Program Officer, but not until September 23, 1987, almost a month after our field work ended. Since this report did not exist during the audit phase, we can only assume that it was generated due to our interest in this subject. An appropriate change was made.
14. The information provided in the Mission's comments were never mentioned to the audit team during the field work phase. First, we were quite surprised that the Controller had no records concerning any action taken on the memo in question from the USAID/G Director, particularly since the memo was addressed to him, and secondly, there was never any mention of a meeting with the Director to resolve the problems. Since PIL No. 12, dated September 29, 1987, was signed after our audit, and we have not received a copy, we have no basis at this time to remove the example from the report.
15. We disagree with the Mission's assertion that the funds are trackable. The audit team visited the Agriculture Development Bank (BANDESA) and the Housing Bank, and at both places the implementing agency officials admitted that, because the ESF monies were commingled with other funds, they were not trackable. Since no one from USAID/Guatemala had ever attempted to track ESF funds at the implementing agency level, the Mission has no basis to refute our position.
16. Appropriate change was made.
17. This strident statement misinterprets our actions. The audit team visited the Central Bank as a legitimate audit step to review attribution of ESF dollars. Had the team not contacted the bank about submitting the FY 1986 ESF attribution report, the Mission might still not have it. The Mission had not provided the Central Bank with guidance as to what type of report was required. Therefore, when the audit team went to visit Bank officials shortly before the report was due to be submitted to the Mission, Bank officials had not yet begun developing it because they were not sure what was required. This lack of guidance led to many of the discrepancies contained in the Bank's report. We have been provided no documentation to indicate that the list we received was deficient in any way. Therefore, until we obtain information to the contrary, the finding and recommendation remains as written.
18. An appropriate change was made to indicate that a judgmental sample of the attribution list was taken. There was nothing faulty with our methodology. The auditors selected the first commodity of the attribution list with a value of \$5,000 or more and every fifth commodity thereafter of the same value or greater. The commodity value of \$5,000 or more was selected because the Bank of Guatemala has a price-checking mechanism for commodities for these values. No documentation has been provided that would cause have us to alter our finding or recommendation.

19. Appropriate change was made.
20. Appropriate change was made.
21. On no less than five separate occasions, on July 8th, 10th, 28th, August 6th and 11th, the audit team attempted to contact the Contraloria de Cuentas, to no avail. Each time we were told that the Contraloria was on strike and a meeting was not possible. The fact remains that the Mission must have a strong monitoring system in place because the Guatemalan Government is not carrying out its monitoring responsibilities as envisioned in the ESF agreements.
22. Appropriate change was made.
23. The following important documents were not in the files:
  1. Bank of Guatemala bank account statement for the 1986
  2. supporting documentation for the ESF implementation letters;
  3. several local currency progress reports;
  4. statement of disbursement from Washington on the grant portion of 1986 dollar cash transfer;
  5. statement of disbursement of 1987 dollar tranche from Washington; and
  6. advice of credit for the 1987 trust fund account from the Bank of Guatemala and Bank of America.

Mission staff were somewhat confused as to the location of the ESF official files. On June 9, 1987 in an interview with the Program Officer, we were told his office had no responsibility for maintaining the ESF official files. These files were maintained by the Mission economist and PDSO. On June 8, 1987 the Mission economist said the Program Office and PDSO were responsible for the official files.

24. We disagree that the Mission had the unilateral authority to use a rate other than the one prescribed in the 1986 ESF agreement, which was the highest rate which was not unlawful.
25. The Mission's comment seeks to satisfy, after the fact, a positive AID/W injunction to the effect that an independent audit of the 1986 ESF local currency program was to be carried out by a local CPA firm, by saying a standard access clause in all AID agreements gives them this option. This is not the same thing in our view.
26. This is not a recommendation. The other pertinent matter section only provides information to the Mission and the report readers.

List of Recommendations

	<u>Page No.</u>
<u>Recommendation No. 1</u>	5
<p>We recommend that USAID/Guatemala provide evidence that a monitoring system has been established and implemented to ensure that Economic Support Fund local currency generations are being properly utilized to accomplish program goals and are adequately safeguarded against fraud, waste and abuse.</p>	
<u>Recommendation No. 2</u>	5
<p>We recommend that USAID/Guatemala obtain evidence that the Ministry of Finance has provided all Guatemalan implementing agencies with written guidance advising them:</p> <ol style="list-style-type: none"><li>a. to set up separate accounts for their "AID-generated" local currencies so that these funds are not commingled with money from other sources; and</li><li>b. how to make disposition of local currencies not expended by December 31 of each year.</li></ol>	
<u>Recommendation No. 3</u>	5
<p>We recommend that USAID/Guatemala request an AID General Counsel ruling as to whether any interest earned on Economic Support Funds should be utilized in the same manner as the originally programmed funds. If the General Counsel holds that interest earned should be utilized in the same manner as the originally programmed funds, then USAID/Guatemala should direct the Ministry of Finance to advise all implementing agencies with written guidance to take the appropriate action.</p>	
<u>Recommendation No. 4</u>	5
<p>We recommend that USAID/Guatemala obtain evidence that the Ministry of Finance has reassigned all 1986 Economic Support Funds that have not been expended.</p>	

Page No.

Recommendation No. 5

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We recommend that USAID/Guatemala:

- a. not certify the 1986 Economic Support Fund commodity listing of \$47,350,000 until the Controller's office has conducted a thorough evaluation of the Bank of Guatemala's records regarding this program and, where necessary, direct the Bank to make the adjustments in order to bring the commodity listing into accordance with the criteria set out in the 1986 agreement; and
- b. assist the Bank of Guatemala in developing a data system in order to make a proper attribution of the dollars made available under the program. USAID/Guatemala should provide documentation of work done showing that transactions were accounted for in accordance with Economic Support Fund agreements.

Recommendation No. 6

12

We recommend that USAID/Guatemala obtain from the Guatemalan Controller's Office an action plan to comply with its auditing responsibilities as laid out in the 1986/87 agreements. This may entail providing local currency resources to hire more personnel, providing proper training and aiding the Government of Guatemala in developing adequate auditing standards or even augmenting the capability of the Guatemalan Controller's office through the use of local CPA firms.

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