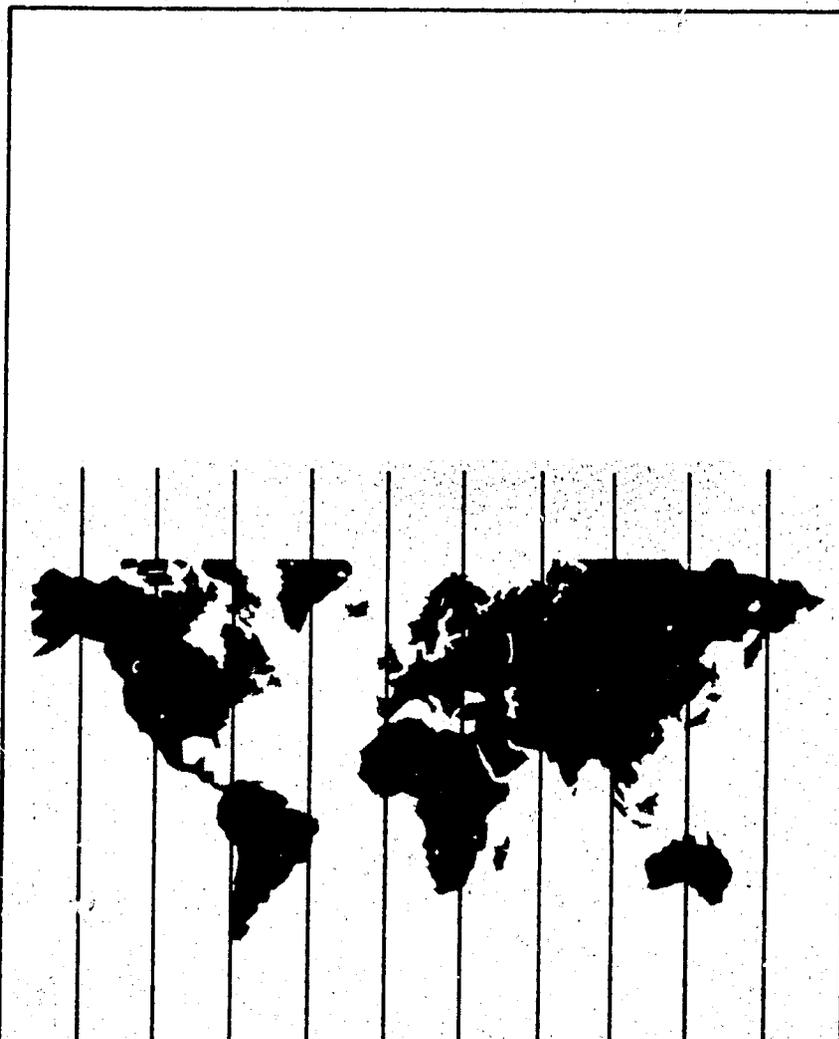


UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE
INSPECTOR
GENERAL



Regional Inspector General for Audit

TEGUCIGALPA

**AUDIT OF USAID PERU'S
UPPER HUALLAGA AREA DEVELOPMENT PROJECT
MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT OFFICE
SEPTEMBER 15, 1981 TO MARCH 31, 1990**

**Audit Report No. 1-527-91-36-N
July 25, 1991**

AGENCY FOR INTERNATIONAL DEVELOPMENT

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July 25, 1991

MEMORANDUM

TO: D/USAID/Peru, Craig Buck

FROM: RIG/A/T, Reginald Howard *Reginald Howard*

SUBJECT: Audit of USAID/Peru's Upper Huallaga Area Development Project,
Managed by the Upper Huallaga Special Project Office, September 15,
1981 to March 31, 1990

This report presents the results of a non-Federal financial audit of the Upper Huallaga Area Development Project, USAID/Peru Project No. 527-0244, managed by the Upper Huallaga Special Project Office (Office). Price Waterhouse prepared the report, which is dated May 29, 1991.

The purpose of the Upper Huallaga Area Development Project is to implement agricultural production packages and to strengthen public sector support services in coordination with the Peruvian coca eradication program in the Upper Huallaga Valley. The audit coverage included \$13,041,528 provided by A.I.D. to the Project.

The objectives of the audit were to determine whether: (1) the Office's fund accountability statement for the period audited fairly presents Project receipts and disbursements, (2) the internal control structure of the Office was adequate to manage the Project's funds, and (3) the Office complied with contract terms and applicable laws and regulations. The scope of the audit included an examination of the Office's activities and transactions to the extent considered necessary to issue a report thereon for the period under audit.

The auditors found that, with the exception of questionable costs of \$43,000, the fund accountability statement fairly presents the receipts and disbursements of the project managed by the Office for the audit period. In addition, the auditors found only minor weaknesses in the internal control structure of the Office, addressed in a separate letter to the Office's management. With respect to compliance the auditors found that the Office complied in all material respects with the relevant agreement terms and applicable laws and regulations.

This report was discussed with the Executive Directorate of the Office, who generally agreed with the report.

We are including the following recommendation in the Office of the Inspector General's recommendation follow-up system:

Recommendation No. 1

We recommend that USAID/Peru negotiate a settlement with the Upper Huallaga Special Project Office for the questioned costs totaling \$43,000, as described in the Price Waterhouse audit report dated May 29, 1991, representing the expenditures made for salaries for the training, investigation and extension components in violation of the agreement terms.

Please advise this office within 30 days of actions planned or taken to resolve and close the recommendation.

AUDIT OF THE UPPER HUALLAGA AREA
DEVELOPMENT PROJECT, USAID/PERU
PROJECT No. 527-0244 MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT
OFFICE - PEAH FROM SEPTEMBER 15,
1981 TO MARCH 31, 1990

AUDIT OF THE UPPER HUALLAGA AREA
DEVELOPMENT PROJECT, USAID/PERU
PROJECT NO.527-0244 MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT
OFFICE - PEAH FROM SEPTEMBER 15, 1981
TO MARCH 31, 1990

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Price Waterhouse



May 29, 1991

Mr. Reginald Howard
Regional Inspector General for Audit
U.S. Agency for International Development
Tegucigalpa, Honduras, C.A.

Dear Mr. Howard:

This report presents the results of our audit of the Upper Huallaga Area Development Project, USAID/PERU Project No.527-0244 managed by the Upper Huallaga Special Project Office - PEAH from September 15, 1981 to March 31, 1990.

BACKGROUND

On September 15, 1981, the Government of the United States of America, acting through the Agency for International Development Mission of Peru (USAID/PERU), and the Government of Peru (GOP), represented by its Ministry of Economy, Finance and Commerce, signed an agreement to develop the Upper Huallaga Area Development Project, USAID/PERU Project No.527-0244, to implement agricultural production packages and to strengthen public sector support services in coordination with the Peruvian coca eradication program in the Upper Huallaga Valley.

The project is being implemented in a coca-based economy and has experienced a number of implementation obstacles, including the difficult security situation in the Upper Huallaga Valley. These factors have caused some reduction in the presence of the government of Peru ministries in the valley, thereby forcing the Upper Huallaga Special Project Office - PEAH, which is tasked with coordinating project inputs, to assume the role of principle project implementor.

Executor entity -

The executive management of the Upper Huallaga Project based in Aucayacu, was created on December 1, 1981 to coordinate and manage the activities and resources of the Project; and operates under the authority of the Instituto Nacional de Desarrollo (INADE) and the Ministry of Presidency.



May 29, 1991
Mr. Reginald Howard
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To develop Project activities, PEAH has signed agreements with different public entities to provide them financial resources from Project funds in order to strengthen their operative capacity according to Project objectives.

Period of the agreement -

The period of the agreement is from September 15, 1981 to September 14, 1991.

Financial plan -

The project financial plan is as follows:

<u>Budget item</u>	<u>Loan</u> US\$000	<u>Grant</u> US\$000	<u>Counterpart</u> US\$000	<u>Total</u> US\$000
Research	1,452	1,669	2,056	5,177
Extension	2,207	1,973	2,848	7,028
Training	912	877	723	2,512
Agricultural credit	3,013	175	1,200	4,388
Farm production service	784	319	254	1,357
Information resources	300	608	474	1,382
Road maintenance	3,623	2,040	3,601	9,264
Community development	732	1,561	1,260	3,553
Special project office	1,808	780	575	3,163
Evaluation	-	145	-	145
Other	53	169	867	1,089
	<u>15,000</u>	<u>10,200</u>	<u>13,858</u>	<u>39,058</u>

Research

The project finances activities designed to develop the human resources of institutions involved in agricultural research, extension and training in the project area.

Extension

The extension component facilitates the adoption of new farming methods developed under the research program.



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Mr. Reginald Howard
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Training

The objective of the training program is to strengthen the capacity of the Universidad Nacional Agraria de la Selva to train professionals with appropriate skills for employment in the Upper Huallaga Valley.

Agricultural credit

The project establishes an agricultural credit program for the project area implemented through the Banco Agrario and BANCOOP, a cooperative rural financial institution.

Farm production services

The project finances activities in land registration, input and output marketing and agroindustrial promotion.

Information resources

The objective of this component is to provide a continual flow of information to project managers to assist them in implementation.

Road maintenance

The objective of this component is to maintain and repair the roads involved in the project area.

Community development

The community development component supports the improvement of essential community services in the area to meet specific needs of the population. These services include: potable water systems, small irrigation canals, health care and public markets.

Special Project Office

Comprises the establishment and operation of the Special Project Office in Aucayacu, including the purchase of equipment and personnel expenses.

May 29, 1991
Mr. Reginald Howard
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AUDIT OBJECTIVES AND SCOPE

We were engaged to perform a financial audit of the Upper Huallaga Area Development Project, USAID/PERU Project No.527-0244, managed by the Upper Huallaga Special Project Office - PEAH, for the period September 15, 1981 to March 31, 1990. Our audit was performed in accordance with generally accepted auditing standards and the United States Comptroller General's "Government Auditing Standards" (1988 Revision) and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary to determine whether:

- The fund accountability statement for the period from September 15, 1981 to March 31, 1990 presents fairly the financial activities of the Project for the period and costs reported as incurred and reimbursed by USAID/PERU during this period are allowable, allocable and reasonable in accordance with agreement terms and applicable laws and regulations.
- The internal control structure of PEAH is adequate to manage the Project's operations.
- PEAH has complied with agreement terms and applicable laws and regulations which may affect the Projects's goals and incurred costs.

The scope of our audit work consists of:

- 1 Monitoring the implementing agency's utilization of funds, commodities and supplies provided under the grant agreement. Monitoring activities included:
- Performing selective review of project related documentation, accounting records and internal control structure.
 - Reviewing the Project's procurement procedures used to determine that sound commercial practices were used, including competition, reasonable prices and adequate qualities as agreed in the Project's agreement.
 - Reviewing the procedures used to control the Project's funds.



May 29, 1991
Mr. Reginald Howard
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- 2 Examination of the fund accountability statement for the implementing agency and for each major component of the Project taken as a whole, through March 31, 1990. Reviewing for any costs which were not fully supported with adequate records or which were not allowable or reasonable under the terms of the agreement. This work included:
 - a) Determining whether advances of Project's funds were justified with documentation, including reconciliations of funds advanced, disbursed and available.
 - b) Reviewing direct and indirect costs billed to USAID/PERU identifying and quantifying any questionable costs.
 - c) Review of the bank accounts and related controls. Obtaining positive confirmation of balances.
- 3 Review and evaluation of the implementing agency's internal control structure to manage the Project. The conduct of preliminary and compliance tests to determine the extent to which established procedures and controls are functioning as intended.
- 4 The scope of our audit work included verification of receipts of funds from the United States Agency for International Development and ensuring the proper accounting treatment and banking of those receipts. We examined supporting documentation for payments on a test basis as considered appropriate in the circumstances.
- 5 We have been alert to situations or transactions that could be indicative of fraud, abuse and illegal expenditures and acts.

RESULTS OF AUDIT

Fund accountability statement

The fund accountability statement was prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles. Based on work performed, as summarized above, in our opinion, the fund accountability statement as of March 31, 1990 presents fairly the financial activities of the Project at that date and costs reported as



May 29, 1991
Mr. Reginald Howard
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incurred and reimbursed by USAID/PERU, during the period ended March 31, 1990 are allowable, allocable and reasonable in accordance with agreement terms and applicable laws and regulations which may affect the Project's goals and incurred costs.

Internal control structure

In planning and performing our audit of the fund accountability statement we considered the internal control structure of the implementing agency in order to determine our auditing procedures for the purpose of expressing an opinion on the fund accountability statement.

Our evaluation of the internal control structure included the systems of internal control surrounding:

- Laws and regulations aspects
- Accounting and financial aspects
- Treasury (receipts and custody of funds)
- Liquidations (includes procurement and payment for goods and services)
- Salaries
- Fixed assets

We noted no matters involving the implementing agency's internal control structure that we believe to be material weaknesses. However, we reported other minor matters to the Management of PEAH in a separate letter.

Compliance with agreement terms and applicable laws and regulations

As part of obtaining reasonable assurance about whether the fund accountability statement is free of material misstatement and in order to render an opinion on compliance with agreement terms and applicable laws and regulations, we performed tests to ensure that PEAH complied with the agreement terms and applicable laws and regulations which may affect Project's goals and incurred costs.

The results of our test of compliance indicate that, with respect to items tested, PEAH has complied, in all material respects, with agreement terms and all applicable laws and regulations which may



May 29, 1991
Mr. Reginald Howard
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affect the Project's goals and incurred costs. With respect to items not tested, nothing came to our attention that caused us to believe that PEAH had not complied, in all material respects, with the terms of the agreement and applicable laws and regulations which may affect the Project's goals and incurred costs.

MANAGEMENT COMMENTS

This report has been discussed with the Executive Director of PEAH, who is in general agreement with the contents of this report. Specific comments are reproduced in Annex 1.

Price Waterhouse

Price Waterhouse



AUDIT OF THE UPPER HUALLAGA AREA
DEVELOPMENT PROJECT, USAID/PERU
PROJECT No. 527-0244 MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT
OFFICE - PEAH FROM SEPTEMBER 15, 1981
TO MARCH 31, 1990

FUND ACCOUNTABILITY STATEMENT
AS OF MARCH 31, 1990

INDEPENDENT AUDITORS' REPORT

November 28, 1990

We have audited the accompanying fund accountability statement of the Upper Huallaga Area Development Project, USAID/PERU Project No. 527-0244, managed by the Upper Huallaga Special Project - PEAH for the period September 15, 1981 to March 31, 1990. This fund accountability statement is the responsibility of the Management of PEAH. Our responsibility is to express an opinion on this fund accountability statement based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the United States Comptroller General's "Government Auditing Standards" (1988 Revision). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatement. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the fund accountability statement. Our audit also included assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall fund accountability statement presentation. We believe that our audit provided a reasonable basis for our opinion.

As described in Note 2, the fund accountability statement was prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the fund accountability statement audited by us presents fairly, in all material respects, the fund position of the Upper Huallaga Area Development Project, USAID/PERU Project No. 527-0244, managed by the Upper Huallaga Special Project - PEAH for the period September 15, 1981 to March 31, 1990, on the basis of accounting described in Note 2.



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This report is intended solely for the use of the United States Agency for International Development and the Upper Huallaga Special Project - PEAH. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

Price Waterhouse

AUDIT OF THE UPPER HUALLAGA AREA
DEVELOPMENT PROJECT, USAID/PERU
PROJECT No.527-0244 MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT
OFFICE - PEAF FROM SEPTEMBER 15, 1981
TO MARCH 31, 1990

FUND ACCOUNTABILITY STATEMENT
FOR THE PERIOD SEPTEMBER 15, 1981
TO MARCH 31, 1990

	Budget			Disbursements			Available			Questionable Costs (Note 3) US\$
	Loan US\$	Grant US\$	Total US\$	Loan US\$	Grant US\$	Total US\$	Loan US\$	Grant US\$	Total US\$	
INCOME										
Funds provided by USAID/Perú	<u>11,396,718</u>	<u>3,648,171</u>	<u>15,044,889</u>	<u>11,076,223</u>	<u>1,965,305</u>	<u>13,041,528</u>	<u>320,495</u>	<u>1,682,866</u>	<u>2,003,361</u>	
DISBURSEMENTS										
Research	1,187,721	138,459	1,326,180	1,172,042	5,520	1,177,562	15,679	132,939	148,618	13,000
Extension	1,504,674	1,088,617	2,593,291	1,430,538	328,608	1,759,146	74,136	760,009	834,145	28,000
Training	785,553	107,398	892,951	770,341	6,328	776,669	15,212	101,070	116,282	2,000
Agricultural credit	3,012,462	-	3,012,462	3,005,824	-	3,005,824	6,638	-	6,638	-
Farm production service	757,259	-	757,259	611,185	-	611,185	146,074	-	146,074	-
Information resources	256,841	38,104	294,945	255,542	2,976	258,518	1,299	35,128	36,427	-
Road maintenance	1,537,272	929,808	2,467,080	1,527,173	334,018	1,861,191	10,099	595,790	605,889	-
Community development	664,820	1,282,953	1,947,773	649,847	794,181	1,444,028	14,973	488,772	503,745	-
Special project office	<u>1,690,116</u>	<u>62,832</u>	<u>1,752,948</u>	<u>1,653,687</u>	<u>-</u>	<u>1,653,687</u>	<u>36,429</u>	<u>62,832</u>	<u>99,261</u>	<u>-</u>
	<u>11,396,178</u>	<u>3,648,171</u>	<u>15,044,889</u>	<u>11,076,179</u>	<u>1,471,631</u>	<u>12,547,810</u>	<u>320,539</u>	<u>2,176,540</u>	<u>2,497,079</u>	<u>43,000</u>
EXCESS (DEFICIT)	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====
	-	-	-	44	493,674	493,718				
	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

Notes 1 to 4 form an integral part of this fund accountability statement.

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AUDIT OF THE UPPER HUALLAGA AREA
DEVELOPMENT PROJECT, USAID/PERU
PROJECT No.527-0244 MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT
OFFICE - PEAH FROM SEPTEMBER 15, 1981
TO MARCH 31, 1990

NOTES TO THE FUND ACCOUNTABILITY STATEMENT
AS OF MARCH 31, 1990

1 NATURE OF ACTIVITIES

The Upper Huallaga Special Project Office - PEAH is the entity responsible for the development and management of Project activities and resources. The Project activities are developed by PEAH directly, as well as by different public entities which have signed agreements with PEAH, according to agreement terms.

2 ACCOUNTING POLICIES

The fund accountability statement is prepared on the basis of cash receipts and disbursements.

In accordance with Peruvian legislation, the accounting transactions are recorded in local currency; the amounts in US dollars shown in the fund accountability statement are translated on a first-in-first-out basis, applying the exchange rate in force at the date of remittance of funds. These translated amounts compared with USAID's accounting records will result in some insignificant differences attributable to the exchange rates used by each entity, considering the date of recording of the transactions.

USAID/PERU has made direct payments on behalf of PEAH for goods and services amounting to US\$8,463,950 which are not included in the Fund Accountability Statement. Consequently, they have not been audited by us.

3 QUESTIONABLE COSTS

During 1986, the Project has financed salaries for training, investigation and extension components with loan resources for approximately US\$43,000, which violates the agreement terms, since it only authorizes supplement payments of salaries and not the total salary expense of the personnel involved in the Projects components.

4 EXCHANGE RATE

The exchange rates applied to translate the amounts shown in the fund accountability statement are as follow:

<u>Year</u>	<u>Exchange rate of year - end</u>
1982	I/. 0.99
1983	2.28
1984	5.71
1985	17.44
1986	20.20
1987	62.82
1988	1,696.28
1989	12,821.27
1990 (March 31)	23,098.01

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AUDIT OF THE UPPER HUALLAGA AREA
DEVELOPMENT PROJECT, USAID/PERU
PROJECT No.527-0244 MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT
OFFICE - PEAH FROM SEPTEMBER 15, 1981
TO MARCH 31, 1990

INTERNAL CONTROL STRUCTURE
AS OF MARCH 31, 1990

INDEPENDENT AUDITORS' REPORT

November 28, 1990

We have audited the fund accountability statement of the Upper Huallaga Area Development Project, USAID/PERU Project No.527-0244, managed by the Upper Huallaga Special Project - PEAH for the period September 15, 1981 to March 31, 1990 and have issued our report thereon dated November 28, 1990.

We conducted our audit in accordance with generally accepted auditing standards and the United States Comptroller General's "Government Auditing Standards" (1988 Revision). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatement.

In planning and performing our audit of the fund accountability statement for the Upper Huallaga Area Development Project, USAID/PERU Project No.527-0244, managed by the Upper Huallaga Special Project - PEAH for the period September 15, 1981 to March 31, 1990 we considered PEAH's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on such statement and not to provide assurance on the internal control structure.



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The Management of the Upper Huallaga Special Project - PEAH is responsible for establishing and maintaining an internal control structure to manage the Project's operations. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the fund accountability statement. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

For the purpose of this report we have classified significant internal control structure policies and procedures into the following categories: i) laws and regulations aspects; ii) accounting and financial aspects; iii) treasury (receipts and custody of funds); iv) liquidations (includes procurement and payment for goods and services); v) salaries; vi) fixed assets.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the fund accountability statement being audited may occur and not be detected within a timely



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period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

However, we noted other matters involving the internal control structure and operations that we reported to PEAH's management in a separate communication dated November 28, 1990.

This report is intended solely for the information and use of the United States Agency for International Development and the Upper Huallaga Special Project - PEAH. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

Price Waterhouse

Price Waterhouse

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AUDIT OF THE UPPER HUALLAGA AREA
DEVELOPMENT PROJECT, USAID/PERU
PROJECT No.527-0244 MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT
OFFICE - PEAH FROM SEPTEMBER 15, 1981
TO MARCH 31, 1990

COMPLIANCE WITH AGREEMENT TERMS AND
APPLICABLE LAWS AND REGULATIONS
AS OF MARCH 31, 1990

INDEPENDENT AUDITORS' REPORT

November 28, 1990

We have audited the fund accountability of the Upper Huallaga Area Development Project, USAID/PERU Project No.527-0244, managed by the Upper Huallaga Special Project - PEAH for the period September 15, 1981 to March 31, 1990 and have issued our report thereon dated November 28, 1990.

We conducted our audit in accordance with generally accepted auditing standards and the United States Comptroller General's "Government Auditing Standards" (1988 Revision). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatement.

The Upper Huallaga Special Project - PEAH is responsible for compliance with the terms of the agreement and applicable laws and regulations. In obtaining reasonable assurance about whether the fund accountability statement is free of material misstatement, we performed tests of compliance by PEAH with agreement terms and applicable laws and regulations which may affect the Project's goals and incurred costs. However, our objective was not to provide an opinion on overall compliance with such provisions.



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The result of our tests indicate that, with respect to the items tested, PEAH complied, in all material respects, with the terms of the agreement and with applicable laws and regulations which may affect the Projects's goals and incurred costs. With respect to items not tested nothing came to our attention that caused us to believe that PEAH had not complied, in all material respects, with the terms of the agreement and with applicable laws and regulations which may affect the Project's goals and incurred costs.

This report is intended solely for the information and use of the United States Agency for International Development and the Upper Huallaga Special Project - PEAH. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

Price Waterhouse

Annex 1

AUDIT OF THE UPPER HUALLAGA AREA
DEVELOPMENT PROJECT, USAID/PERU
PROJECT No.527-0244 MANAGED BY
THE UPPER HUALLAGA SPECIAL PROJECT
OFFICE - PEAH FROM SEPTEMBER 15, 1981
TO MARCH 31, 1990

MANAGEMENT COMMENTS
AS OF MARCH 31, 1990

The Executive Director of the Upper Huallaga Special Project - PEAH,
has provided the following comment:

We were pleased to receive your final draft with regard to the
concurrent audit of this project. We have read the report
thoroughly and we agree with its contents.

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APPENDIX

REPORT DISTRIBUTION

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