

**Regional Inspector General for Audit
Tegucigalpa, Honduras**

**Audit of USAID/Panama's
Economic Support Fund Program
Funded by the Fiscal Year 1990 Dire
Emergency Supplemental Appropriations Act
May 25, 1990 to September 30, 1991**

**Audit Report No. 1-525-92-30-N
June 3, 1992**



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AGENCY FOR INTERNATIONAL DEVELOPMENT

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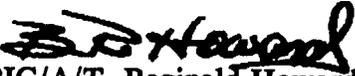
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June 3, 1992

MEMORANDUM

TO: D/USAID/Panama, Thomas W. Stukel

FROM: 
RIG/A/T, Reginald Howard

SUBJECT: Audit of USAID/Panama's Economic Support Fund Program, Funded by the Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act, May 25, 1990 to September 30, 1991

This report presents the results of a financial audit of USAID/Panama's Economic Support Fund Program (Program) for the period May 25, 1990 to September 30, 1991. A.I.D. funding of \$420 million was authorized for the Program by the Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act. The purpose of the Program is to provide support for the economic recovery of Panama. This audit was limited to those implementing entities which conducted their financial and/or administrative operations within Panama. The accounting firm of KPMG Peat Marwick prepared the report which is dated January 22, 1992.

The Program includes two major types of assistance:

- Cash transfer assistance--for increased credit to the private sector, repayment of debt in arrears, and budget support for public investment, and
- Development assistance--for support of the new Panamanian Government's economic recovery and social programs.

The objectives of the audit were to determine whether: (1) the implementing entities' consolidated fund accountability statement presents fairly, in all material respects, the local financial activities under the Program during the period audited, (2) the implementing entities' internal control structures were adequate to ensure appropriate control over the Program's activities, and (3) the implementing entities had complied, in all material respects, with the terms of the Program Agreements and applicable laws and regulations. The scope of the audit included an examination of the implementing entities'

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activities and transactions, executed within Panama, to the extent considered necessary to issue a report thereon for the period under audit.

The report includes audit coverage of funding provided under:

- the Budget Support subprogram of the Economic Recovery Program, Project No. 525-0303 and Private Sector Reactivation Program, Project No. 525-0304, managed by the National Bank of Panama, and
- Local Scholarships, Project No. 525-0281, managed by the National Foundation for Panamanian Rural Youth.

The audit coverage included expenditures of A.I.D. funds totaling \$122.36 million during the audit period for which records were available in Panama.

KPMG found that the Program's consolidated fund accountability statement, with the exception of questionable costs of \$2,886, presents fairly, in all material respects, the local financial activities of the implementing agencies for the period audited. The questionable costs related to expenditures in excess of approved budget amounts by the National Bank of Panama under the Private Sector Reactivation Program.

The auditors, however, reported in Note 4 to the consolidated fund accountability statement (page 27 of the KPMG report), certain discrepancies in eligibility criteria for the Private Sector Reactivation Program. These discrepancies center around two issues. First, a crucial word change occurred between the Program Assistance Approval Document and the Program's Agreement. The Program Assistance Approval Document stated that "Banks that plan to expand their medium and long term loan portfolio...will submit [emphasis added]...a description of the new loans that they plan to make within the next 30 days". In the Program's Agreement, however, the word "will" was changed to "may". Using this change from "will submit" to "may submit" both A.I.D. and National Bank of Panama officials considered the submission of new loans by participating banks to be nonbinding.

Second, the Agreement does not provide for the effective date or cut-off date for new loan consideration. It does require that agreements be executed between the participating banks and National Bank of Panama. Using these various agreement dates the auditors determined that \$21.6 million in ICDs were purchased based on loan documentation dated prior to these agreement dates. The auditors did not question the \$21.6 million due to the lack of clear criteria and stated the eligibility date criteria must ultimately be addressed by the U.S. and Panama Governments. The effect of these discrepancies is discussed in detail in A.I.D. Inspector General Audit Report No. 1-525-92-006, dated March 30, 1992.

KPMG identified six reportable conditions in the internal control structures of the two implementing entities, none of which were considered significant. In their review of compliance with terms of the various Program Agreements and applicable laws and

regulations, the auditors identified four areas of material noncompliance by the two implementing entities. KPMG made no recommendations concerning problems identified at the National Bank of Panama since corrective actions were taken upon notification. The auditors reported material noncompliance by the National Foundation for Panamanian Rural Youth regarding the recording of counterpart contributions and the achievement of Project goals.

The draft report was discussed with management officials of the implementing entities and USAID/Panama who expressed general agreement with the report's content except for Notes 2 and 4 to the Fund Accountability Statement concerning accounting policies at the National Bank of Panama and the Private Sector Reactivation Program. The National Bank of Panama provided written comments which were considered in the final report and are included as Annex I to the KPMG report.

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

Recommendation No. 1

We recommend that USAID/Panama resolve the questionable (all questioned) costs of \$2,886 identified in the KPMG Peat Marwick audit report dated January 22, 1992, and recover from the National Bank of Panama all amounts determined to be unallowable.

Recommendation No. 2

We recommend that USAID/Panama, in conjunction with the Government of Panama, determine the eligibility of the \$21.6 million in ICDs purchased based on loan documentation dated prior to the dates of the various agreements signed between the participating banks and the National Bank of Panama.

Recommendation No. 3

We recommend that USAID/Panama, in conjunction with the National Foundation for Panamanian Rural Youth, develop a plan, including a timetable for implementation, to: (1) establish procedures to ensure that counterpart contributions to the Project are properly recorded, and (2) analyze the cash flow needs and determine if the amount of Project advance currently established is adequate to cover Project needs in a timely manner.

This final audit report is being transmitted to you for your action. Please advise this office within 30 days of actions planned or taken to resolve and close the recommendations.

**FINANCIAL AUDIT FOR THE LOCAL
EXECUTION OF THE FISCAL YEAR 1990
USAID/ECONOMIC SUPPORT FUND (ESF)
PROGRAM FOR PANAMA FOR THE PERIOD
MAY 25, 1990 THROUGH SEPTEMBER 30, 1991**

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**FINANCIAL AUDIT OF THE LOCAL EXECUTION OF THE FISCAL YEAR 1990
USAID/ECONOMIC SUPPORT FUND (ESF) PROGRAM FOR PANAMA
FUNDED UNDER PUBLIC LAW 101-302 FOR THE PERIOD
MAY 25, 1990 THROUGH SEPTEMBER 30, 1991**

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January 22, 1992

Mr. Reginald Howard
Regional Inspector General for
Audit (RIG/A/T)
US Agency for International
Development
Tegucigalpa, Honduras, C. A.

Dear Mr. Howard:

This report presents the results of our financial audit of the local execution of all initiated activities of the USAID/ Economic Support Fund (ESF) Program for Panama for the period May 25, 1990 through September 30, 1991.

BACKGROUND

On May 25, 1990, by means of US Public Law 101-302 "The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act", the Government of the United States of America authorized an Economic Support Fund assistance to support the economic recovery of the Republic of Panama. This program for US \$420 million includes five major categories of assistance:

- a. Cash transfer assistance for repayment of Government of Panama's (GOP) debt in arrears, budget support to the GOP's 1990-91 public investment budget and to provide stand-by immediate liquidity to the banking system.
- b. Disbursements over a longer term development projects in support of social activities, democratic initiatives and economic policy reforms.
- c. Disbursements under the emergency and immediate recovery phases of assistance to Panama.

- d. Disbursements to repay A.I.D.'s Office of Foreign Disaster Assistance (OFDA) funds for housing rehabilitation activities under the emergency phase of the assistance.
- e. Disbursements of funds for USAID/Panama operating expenses and the design of new projects.

Cash Transfers

There are two cash transfer programs. The first called Economic Recovery Program has two subprograms: one for the repayment of Panama's debt arrears and the other for budget support to Panama's public sector investment budget. The second program, called Private Sector Reactivation Program, provides added liquidity to Panama's banking system.

For both programs the principal Panamanian Government entity involved is the National Bank of Panama (Banco Nacional de Panama-BNP).

On July 3, 1990, a grant agreement was signed for the Economic Recovery Program, USAID/Panama Program No. 525-0303, to implement policy reforms for economic recovery and to help restore the creditworthiness of the Panamanian public sector. The program has two subprograms: (1) US \$130 million for repayment of GOP's debt arrears, and (2) US \$113.85 million for budget support to the GOP's 1990-91 public investment budget.

As of September 30, 1991, the Government of Panama did not meet the conditions precedent specified in the agreement for the use of the funds of the subprogram for the repayment of GOP debt arrears.

On October 23, 1990, US \$29.85 million was disbursed to an account established with the Federal Reserve Bank of New York in the name of the National Bank of Panama (BNP), corresponding to the first "tranche" of the second subprogram. The agreement specifies that the deposit of funds into the GOP's Special Priority Investment Fund (SPIF) is the end use of funds for this subprogram, as defined by A.I.D.

The agreement also states that the Comptroller's General Office of Panama will contract an independent financial review of disbursements out of the SPIF to activities it finances.

On July 24, 1990, a second grant agreement was signed for the Private Sector Reactivation Program, USAID/Panama, Project No. 525-0304 under which US \$107.9 million was provided for immediate liquidity to the banking system and for private sector lending in Panama. The main objective of the program is to make funds available to domestic and foreign banks with general licenses to do business in Panama so that they can perform incremental lending activities to the productive private sector. As of September 30, 1991, the three installments of US \$36 million, US \$36 million, and US \$35.9 million, respectively were totally disbursed.

USAID/Panama has defined the transaction of purchases of interbank certificates of deposits to be the end use of funds. BNP has distributed to the banks an Operations Manual which specifies eligible and prohibited uses of program funds. Participating banks fill out the statistical forms in which BNP relies upon to support disbursements. The BNP does not examine the originating loan documentation.

The program operates under the assumption that participating banks will be able to cancel at due date their issued interbank certificates of deposits. Panama's National Banking Commission has the obligation for the normal supervision of Panama's banking system.

Development Projects

The purpose of development projects is to assist Panama in addressing specific problems. As of September 30, 1991, USAID/Panama had planned 18 development projects in the areas of training, police services, financial administration, environmental protection, private enterprise, and democratic initiatives.

On September 20, 1990, pursuant to the authority contained in the Foreign Assistance Act of 1961, USAID thereby amended the grant agreement No. 525-0281 for The National Foundation for Panamanian Rural Youth (Patronato Nacional de la Juventud Rural Panameña-PANAJURU), to provide additional funding in the amount of US \$500,000 and to add a new project description to the subject Grant. As of September 30, 1991 a total amount of US \$108,900 was disbursed under this grant for rural youth scholarship program for inland technical training in agriculture.

As of September 30, 1991, out of the 18 development projects originally identified by USAID/Panama, the following projects reached the agreement stage:

1. **Private Sector Scholarships Fund - (USAID 525-0258)**
This allowance of US \$500,000 to the National Private Sector Council for Educational Assistance (Consejo del Sector Privado para la Asistencia Educativa - COSPAE) provides funds to amend an existing allowance. The purpose of the project is to identify private sector training needs, select trainees, arrange training programs and successfully reincorporate training participants into the Panamanian economy.

The agreement provides that the second phase activities not to start until the first phase is finished.

2. **Improving Police Services - (USAID 525-0305)** This project of US \$13,200,000 is to establish a modern, professional, civilian controlled police force to provide security of life and property in Panama while respecting human rights and using minimal force. The project will provide training, technical assistance and commodities to strengthen Panama's newly formed police force.

The general objective of the financial audit excludes this project, since it is implemented through the US Department of Justice's International Criminal Investigative Training Assistance Program (ICITAP) which main office is in Washington D.C.

3. **Financial Management Reform - (USAID 525-0306)** This project of US \$4,500,000 is to improve and integrate the GOP's financial management and audit systems and promote accountability of government officials in managing public resources. The goal is to strengthen the management capability of the GOP and renew domestic and international confidence in the integrity and technical competence of the Government.

Implementation of the project will be the overall responsibility of the Comptroller General of Panama. However, the Ministry of Planning and Economic Policy (Ministerio de Planificación y Política Económica - MIPPE) will oversee the development of the budgeting and debt management subsystems and the Ministry of Finance and Treasury (Ministerio de Hacienda y Tesoro - MHT)

will oversee the development of the cash management subsystem.

As of September 30, 1991 the conditions precedent of this project were not yet met.

4. **Democratic Initiative - (USAID 525-0307)** This project provides US \$2,310,000 for various economic and social activities subprojects. These subprojects include:

- a. **Journalism Strengthening** - This subproject of US \$500,000 is to assist the journalistic profession in Panama in adjusting to its new press freedom in a professional and responsible manner. This 12-month subproject will provide seminars, training, and technical assistance activities based on the professional standards of the free press.

Florida International University (FIU) of Miami, Florida is the implementing entity, and contracting is being done by A.I.D./Washington. The Mission officer is not involved in the approval of the expenses related to this subproject and there is still an amendable agreement not yet finalized which includes reporting requirements to the Mission.

This subproject is out of the scope of the audit work since the records are not available within Panama.

- b. **Civic Education** - This subproject of US \$240,000 is to promote the development of democracy in Panama. This will be done by providing financial support through America's Development Foundation (ADF) for programs to be implemented by Panama's National Civic Crusade Foundation (Fundación Cruzada Civilista Nacional) specifically its Pro Democracy Center. A suballowance will support the Center's institutional development and its program activities directed at guiding national business, professional, and grass-roots organizations, and the people of Panama through the transition toward a more democratic society.

ADF located in Alexandria, Virginia is the subproject's grantee and the Civic Crusade located in Panama City is the subgrantee. The granted agreement for this subproject was executed on November 30, 1990.

This subproject is out of the scope of the audit work since the records are not available within Panama.

- c. **Aid to the Electoral Tribunal** - This subproject of US \$840,000 was to assist the Panamanian Electoral Tribunal in preparing for special elections held on January 27, 1991. These elections replaced the elections held in May 1989 whose results have been challenged as questionable. This project provides technical assistance, training, and commodities to strengthen the capacity of the Panamanian Electoral Tribunal in the areas of voter registration, identification, and election administration.

The International Institute for Human Rights/Center for Advice and Promotion of Elections (Instituto Internacional para los Derechos Humanos/Centro para Asesoría y Promoción Electoral-IIDH/CAPEL), a regional organization based in Costa Rica, with expertise in providing this type of assistance, was selected as the implementing entity.

As of September 30, 1991, a total of US \$630,000 had been disbursed corresponding to Technical Assistance. This subproject is out of the scope of the audit work since it represents USAID/Panama direct disbursement.

- d. **Regional Legislative Development** - This subproject of US \$700,000 is to increase the capability of Panama's Legislative Assembly to carry out its role in a democratic government.

The Consortium for Legislative Development, a joint venture composed of the Center for Democracy (Washington, D.C.), Florida International University (Miami, Florida), and the State University of New York (Albany, New York), will be responsible for implementing both the regional project and the Mission's subproject.

The payment vehicle is a letter of credit and USAID/Panama will rely upon the grantee's external audit to assure the allowability of expenses charged to USAID/Panama funds. The Mission's project officer will monitor activities taking place in Panama.

As of September 30, 1991, all the disbursements made under this project, correspond to technical assistance, commodities and training contracted by USAID/Panama which are considered to be out of the scope of this audit.

e. **Purchase of Commodities** - This subproject of US\$30,000 constitutes provisions for office equipment (typewriters) for the Panama City offices of the Electoral Tribunal and additional commodities (desks, chairs, file cabinets, etc.) for the Tribunal's regional offices. USAID/Panama will do the procurement without further approval from the Grantee. The final list of equipment to be procured hereunder shall be agreed in writing by both parties by means of a separate letter.

5. **Natural Resource Management - (USAID 525-0308)** This project of US \$10,000,000 is to improve conservation, management and sustained productivity of soil, water and forest resources through actions of both; public and private sectors. Its goal is to protect and manage Panama's renewable natural resources to permit sustained economic and social development.

The implementing entity for the first three components of the project is the National Institute for Renewable Natural Resources (Instituto de Recursos Naturales Renovables-INRENARE), a semi-autonomous agency of the Government of Panama within the portfolio of the Ministry for Planning and Economic Policy (MIPPE).

As of September 30, 1991, the conditions precedent to this project were met; however the implementing activities were not initiated.

6. **Export and Investment Promotion - (USAID 525-0309)** This project of US \$2,000,000 is to help diversify the Panamanian economy away from the traditional service sector into other sectors that are export oriented. The goal is to increase levels of employment, productivity, and foreign exchange in Panama. The project will focus on making selected areas of nontraditional agricultural and industrial sectors more competitive and it will promote the development of the tourism

sector by encouraging key policy changes which impact this sector.

As of September 30, 1991, this project was cancelled by USAID/Panama and the budgeted amount was reprogrammed to other projects.

7. **Peace Corps - Natural Resources Management - (USAID 525-0310)** This project of US \$100,000 is to provide project support to Peace Corps volunteers who will serve in a program of assistance in natural resources in Panama.

Peace Corps volunteers will work in activities such as agricultural extension, agro-forestry, forest extension, environmental education, small business development, community development, and related activities. Their initial efforts will focus on the Panama Canal watershed, primarily in the Chagres National Park.

This project is out of the scope of the audit work, since all the implementing activities are carried out by other US Government entities.

8. **USIA - Training - (USAID 525-0311)** This project of US \$500,000 is to assist Panamanian efforts to reestablish and consolidate representative democratic government with full public participation. The US Information Agency (USIA) will provide training aimed at strengthening democratic institutions. The training will be in such areas as the role of the legislature in democratic government, public administration, labor issues, journalism, community leadership and other topics related to pluralism and democracy.

This project is out of the scope of the audit work, since all the implementing activities are carried out by other US Government entity.

9. **Improved Administration of Justice - (USAID 525-0312)** This project of US \$6,900,000 is to strengthen and support an independent judicial system which is adequately financed and operating in an impartial manner. The project includes:
 - Modernization and professionalization of the court system.
 - Modernization and professionalization of The Public Ministry.

- Revitalization of public defenders programs.
- Provision of basic legal materials to all judges and prosecutors.
- Strengthening planning and coordination between the Judiciary and Public Ministry.

As of September 30, 1991, a total direct USAID/Panama disbursements of US \$30,484 corresponding to technical assistance and purchase of commodities, need not be audited.

10. **Economic Policy Development - (USAID 525-0313)** This project of US \$3,100,000 is to improve the economic policy environment and develop incentives for private sector growth.

As of September 30, 1991, the project's conditions precedent were met, however the implementing activities were not initiated.

11. **Tax Administration Improvement - (USAID 525-0314)** This project of US \$1,600,000 is to transfer both technical and managerial expertise to Panama's Director General of Income (Dirección General de Ingresos-DGI) to improve its capabilities to enforce the country's tax laws. The goal is to achieve a self-sufficient Panamanian tax administration.

As of September 30, 1991, the project was in its initiative stage, however direct payments were made for technical assistance and purchase of commodities.

12. **Central American Peace Scholarships - (USAID 525-1000)** This project of US \$5,450,000 is to equip a broad base of leaders and potential leaders in Panama with technical skills, training, academic education, and an appreciation/understanding of the working of a free enterprise economy in a democratic society. This will be a continuation of on-going activities under a current contract with Georgetown University which provides academic scholarships for Panamanian students. It is anticipated that approximately 90 students will receive long-term academic scholarships.

As of September 30, 1991, this project was reprogrammed in two subprojects, one of the subprojects implementing activities has not been initiated, and the other is still in the signature stage.

13. **AIFLD Labor Development - (USAID 598-0790)** The purpose of this project of US \$500,000 is to assist free and democratic labor organizations and unions in Latin American countries to develop effective, enlightened and responsible trade union leadership.

The implementing entity is the American Institute for Free Labor Development (AIFLD) headquartered in Washington, D.C. A.I.D.'s support to AIFLD is through A.I.D.'s Latin America and Caribbean Bureau.

14. **AIFLD Labor Development - (USAID 525-0319)** The purpose of this allowance of US \$138,000 is to provide technical assistance and training, as well as limited budget support to the Confederación de Trabajadores de la República de Panama (CTRP).

As of September 30, 1991, this project was not yet initiated.

15. **Drug Awareness and Prevention - (USAID 525-0320)** The purpose of this allowance of US \$250,000 is to upgrade the technical capability of the staff of Cruz Blanca and provide training for approximately 1,440 volunteers in modern techniques of drug awareness and prevention enabling them to actively participate in programs designed to increase public awareness of the adverse effects of illegal drug usage and ways of prevention.

As of September 30, 1991, this project was not yet initiated.

16. **Private Sector Low Cost Shelter - (USAID 525-0287)** This project of US \$300,000 gives support to the Housing Guaranty (HG) program, A.I.D. will provide technical assistance to increase involvement of the private sector in long-term mortgage lending for low-cost shelter, to prepare for resumption of HG programs, and to reduce construction costs.

As of September 30, 1991, this project was not yet initiated.

17. **Caribbean and Latin American Scholarship Program II - (USAID 525-1001)** This Grant Agreement dated September 30, 1991 for the amount of US \$4,360,000 consists of a series of

activities to promote broad based-economic and social development by equipping a broad base of leaders and potential leaders with technical skills, training and academic education and an appreciation and understanding of the working of a free enterprise economy in a democratic society.

As of September 30, 1991, this project was not yet initiated.

AUDIT OBJECTIVES

The general objectives of this audit work are to assess the financial management and administrative systems established to control the US \$420 million of Economic Support Fund assistance provide to Panama under Public Law 101-302, "The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act". The specific objectives of the financial audit were to determine whether:

- a. The fund accountability statement presents fairly the financial activities of the Program incurred within Panama during the period May 25, 1990 through September 30, 1991 and that costs reported as incurred were allowable, allocable and reasonable in accordance with the terms of the agreements and applicable laws and regulations;
- b. The internal control structures of the implementing entities are adequate to manage the program's operations; and
- c. The implementing entities have complied with the terms of the agreements and applicable laws and regulations which may affect the program's goals and incurred costs.

SCOPE OF WORK

To meet stated audit and review objectives, among others matters, our work included the following:

A. Preliminary Steps

Review of the following documents to become familiar with the program:

1. Program Assistance Approval Documents (PAAD's) - Economic Recovery Program, No. 525-0303, dated June 19, 1990, and Private Sector Reactivation Program, No. 525-0304, dated July 16, 1990.
2. Grant and Contract Agreement for initiated projects, together with Project Implementation Letters (PILs), contract amendments, and relevant correspondence.
3. Subgrants and subcontracts, as applicable.
4. State Cable 194322 - Subject: Financial Management Guidance on Dollars Separate Accounts for ESF Cash Transfers and ESF, DA and DFA - Funded Non-Project Sector Assistance Cash Disbursements (dated June 1990).
5. OMB Circular A-133 "Audits of Institutions of Higher Education and other Non-profit Organizations".
6. US Office of Management and Budget (OMB) Circular A-122 "Cost Principles for Non-profit Organizations".
7. Mandatory Standard provisions for both US and Non-US, Non-Governmental Grantees.
8. OMB Circular A-110 "Grants and Agreements with Institutions of Higher Education, Hospitals and other Nonprofit Organizations".
9. A.I.D. Handbook 11, Chapter 4, which discusses host country contracts. Cost principles for borrower/grantee contracts.

10. A.I.D. Handbook 13, Mandatory Standard Provision for Non-US; Non-Governmental Grantees.
11. Past external audit reports, if any, on the proposed implementing entities. Project No. 525-0258, 525-0281, and 525-1000 are continuations of existing project activities and may have external audits specifically concerning the past project activities.
12. RIG/A/T audit report No. 1-525-91-05 dated 2/8/91.

B. Audit of the Program

The engagement of the financial audit, included all initiated activities of the Economic Support Fund (ESF) Program, funded under Public Law 101-302 with the exception of projects numbers 525-0300 which was not audited, the housing, food, and shelter activities under Project No. 525-0302 (which will be audited by another accounting firm), Project No. 525-0305, 525-0310, 525-0311 which are implemented through other US Government entities and Mission expenses for project development and operations which were not to be audited.

The scope of the audit work included the review of the following program activities through September 30, 1991 to the extent that they could be audited from records available within the country:

- a. Economic Recovery Program, Project No. 525-0303,
- b. Private Sector Reactivation Program, Project No. 525-0304,
- c. PANAJURU Local Scholarships Project, Project No. 525-0281,
- d. The Democratic Initiative Project, Project No. 525-0307, including its five subprojects,
- e. Central American Peace Scholarships Projects, Project No. 525-1000,
- f. AIFLD Labor Development Program, Project No. 598-0790, and

- g. Any other of the projects planned for obligation during FY 1991 to the extent they incurred expenditures under the program through the audit cut-off date.

The audit work focused upon the activities which took place within the Republic of Panama.

C. Financial Audit of the Program's Local Execution/Disbursements

The audit of the programs and projects, required the following:

1. Examination of the fund accountability statement for the overall local execution of the program from May 25, 1990 to September 30, 1991 including the budgeted amounts by category and major items. The audit included steps and procedures to ascertain whether required counterpart contribution had been provided in accordance with the agreements and to verify that direct A.I.D. procurements were accounted for and control procedures exist to adequately safeguard such assets.

Our work included review of program implementation and accomplishments to determine if commodities were properly managed and costs reported as incurred were allowable, allocable, and reasonable under the terms of the agreements.

Although that was not the purpose of our financial audit, we were alert to situations or transactions that could be indicative of fraud, abuse or illegal expenditures or acts.

2. Evaluation of the implementing entities' internal control structure with particular emphasis in the control environment, the accounting system, and control procedures. For these purposes we conducted compliance and substantive test to determine the extent to which established procedures and controls are functioning as intended and the adequacy of the accounting and information systems, procurement procedures and practices, inventory controls, bank accounts controls, and programs were proper and adequately documented.

In fulfilling the audit objectives and assessing the level of control risk, we followed the guidance contained in applicable AICPA Statements on Auditing Standards. Therefore our work included:

- a. Obtaining sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing, and extent of tests to be performed.
- b. Obtaining sufficient understanding with policies and procedures that pertain to the implementing entity's ability to record, process, summarize, and report financial data consistent with the fund accountability statement and to ensure compliance with the terms and applicable laws and regulations.
- c. Examination of the implementing entity's procurement system to determine if the system follows sound commercial practices and meets A.I.D. regulations.
- d. Evaluation of whether the implementing entity maintains separate bank accounts for project activities, and whether the controls on those bank accounts are adequate for project purposes.
- e. Evaluation of whether the Government of Panama (GOP) and the implementing entities complied with the terms of the agreements and with applicable laws and regulations.

RESULTS OF AUDIT

FUND ACCOUNTABILITY STATEMENT

Except for the effects of the matters mentioned in the following paragraph, the fund accountability statement examined by us presents fairly, in all material respects, the cash receipts and the locally made disbursements of the Economic Support Fund (ESF) Program for Panama for the period May 25, 1990 through September 30, 1991.

As further described in Note 3 to the fund accountability statement, disbursements amounting to U.S. \$2,886 have been questioned for the reasons explained therein.

INTERNAL CONTROL STRUCTURE

Our evaluation of the internal control structure of the program's implementing entities disclosed certain reportable conditions which are summarized as follows:

Private Sector Reactivation Program (USAID/Panama 525-0304) - National Bank of Panama.

1. The Implementing Entity for the Private Sector Reactivation Program has not issued written job descriptions.
2. The evaluation of the participating bank's net worth level, applied under the program was inadequately documented.
3. Dates of certain loans on which the placing of ICD's were based, were prior to the effective date of the agreement, which make them ineligible as credit expansion loans.
4. Some Interbank Certificates of Deposits were placed for periods longer than those established by the Implementing Entity's Operations Manual.

Local Scholarship Project (USAID/Panama 525-0281) - National Foundation for Panamanian Rural Youth.

5. The National Foundation for Panamanian Rural Youth (PANAJURU) has not allocated indirect follow-up cost among the two scholarship plans.
6. PANAJURU has not issued written job descriptions.

COMPLIANCE WITH AGREEMENTS TERMS AND APPLICABLE LAWS AND REGULATIONS

Our tests for compliance with the agreements terms and applicable laws and regulations disclosed the following:

Private Sector Reactivation Program (USAID/Panama 525-0304) - National Bank of Panama.

1. A transfer of funds went from the Separate Account (Federal Reserve Bank) to an intermediate account other than a commingled account (as required by the Agreement) of a Participating Bank.
2. The Implementing Entity did not comply with the submission to USAID/Panama of monthly statements of cash receipts and disbursements of the Separate Account.

Local Scholarship Project (USAID/Panama 525-0281) The National Foundation for Panamanian Rural Youth.

3. The entity has not established procedures to review and guarantee proper control and recording of their counterpart contribution according to the project's budget.
4. Due to delays in obtaining reimbursement of expenses paid, the implementing entity has confronted liquidity problems in achieving project's goals.

MANAGEMENT COMMENTS

Draft reports were discussed at exit conferences held on November 27 and 29, 1991, which were attended by representatives of RIG/A/T, USAID/Panama, PANAJURU and BNP. Additional explanation and/or evidence regarding certain findings and costs initially questioned were provided, and where appropriate, changes have been incorporated into this report. Except for some opinions expressed on the contents of certain notes to the Fund Accountability Statement, BNP's officials, expressed their general agreement with the report findings and recommendations. The entire text of the written BNP's comments is included in Annex 1 of this report.

PANAJURU expressed verbal general agreement with the report findings and recommendations. No written response has been received.

AUDITOR'S RESPONSE

With respect to BNP's comments, we must indicate that our report, as explained more fully in the notes to the Fund Accountability Statement, is not questioning the eligibility of the loans made under the program, but merely disclosing the fact that there is concern as to the correct interpretation of a clause of the Agreement of Program N°525-0304. This concern, among other things, is based on a discrepancy between the PAAD and the Agreement.

KPMG Peat Marwick

**FINANCIAL AUDIT FOR THE LOCAL EXECUTION OF THE
FISCAL YEAR 1990
USAID/ECONOMIC SUPPORT FUND (ESF) PROGRAM FOR
PANAMA FOR THE PERIOD
MAY 25, 1990 THROUGH SEPTEMBER 30, 1991**

FUND ACCOUNTABILITY STATEMENT

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying fund accountability statement for the local execution of the USAID/ Economic Support Fund (ESF) Program for Panama funded under Public Law 101-302 "The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act" for the period May 25, 1990 through September 30, 1991. This fund accountability statement is the responsibility of the Government of Panama (GOP) and the Program Implementing Entities' managements. 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 Government Auditing Standards issued by the Comptroller General of the United States (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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the fund accountability statement. An audit also includes 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 provides 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.

The accompanying fund accountability statement includes US \$2,886 of questionable costs, as described in Note 3. These costs have been discussed with the entities' management as stated in the findings and recommendation section of this report.

In our opinion, except for the effect of the matter discussed in the preceding paragraph, the fund accountability statement referred to above presents fairly, in all material respects, the cash receipts and the locally incurred disbursements of the USAID/ Economic Support Fund (ESF) Program for Panama funded under Public Law 101-302 "The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act" for the period May 25, 1990 through September 30, 1991.

As discussed in Note 4 to the fund accountability statement, question has been raised as to the correct interpretation of a clause of the Private Sector Reactivation Program Agreement. This clause relates to a previous submission by the Participating Banks to the Program Management Unit, of a description of their proposed incremental lending activities. The ultimate determination of the correct interpretation of the clause should be made by the Governments of the United States of America and the Republic of Panama, and cannot be presently determined by us.

This report is intended for the information of the Government of Panama, the program implementing entities and the U.S. Agency for International Development. This restriction is not intended to limit distribution of this report which, upon acceptance by the office of the Regional Inspector General, is a matter of public record.

KPMG Peat Marwick

October 11, 1991 except for Note 5 as to
which the date is November 18, 1991

FINANCIAL AUDIT OF THE LOCAL EXECUTION OF THE
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FUND ACCOUNTABILITY STATEMENT FOR THE PERIOD
MAY 25, 1990 THROUGH SEPTEMBER 30, 1991
(Expressed in thousands of U.S. Dollars)

Number	UNAUDITED				AUDITED				
	Budget	Amount Obligated	Disbursed according to USAID/Panama	USAID direct disbursement	Receipts	Local execution	Questionable costs (Note 3)	Cash in banks	
CASH TRANSFERS:									
525-0303	Economic Recovery Program								
	Repayment of Debt Arrearages	130,000	130,000						
	Support to Budget	113,850	113,850	20,850	31,065	20,850		1,215	
525-0304	Private Sector Reactivation Program	107,900	107,900	107,900	107,900	92,308	3	15,499	
	Sub-total Cash Transfers	<u>351,750</u>	<u>351,750</u>	<u>137,750</u>	<u>0</u>	<u>138,965</u>	<u>122,248</u>	<u>3</u>	<u>16,714</u>
DEVELOPMENT PROJECTS:									
525-0258	COSPAE-Private Sector Scholarships	500	500						
525-0281	PANAJURU-Local Scholarships	500	500		100	100			
525-0287	Private Sector Low Cost Shelter	300	300						
525-0302	Immediate Recovery Program	7,255	7,255	6,281					
525-0305	Police Service	13,200	13,200						
525-0306	Financial Management Reforms	4,500	4,500						
525-0307	Democratic Initiative: Journalism Strengthening	500	500						
	Civic Education	240	240	27	27				
	Aid to Electoral Tribunal	840	840	630	630				
	Legislative Development	700	700						
	Purchase of Commodities	30	30						
525-0308	Natural Resource Management	10,000	10,000						
525-0310	Peace Corp	100	100						
525-0311	USIS	500	500						
525-0312	Improved Administration of Justice	6,900	6,900	30	30				
525-0313	Economic Policy Development	3,100	3,100						
525-0314	Tax Administration Improvement	1,600	1,600	40	40				
525-0319	AIFLD Labor Develop. Program	138	138						
525-0320	Drug Awareness and Prevention	250	250						
525-1000	Central American Peace Scholarships Participant Training Program	5,450	5,450						
525-1001	Caribbean and Latin American Scholarship Program	4,360	4,360						
598-0790	AIFLD Labor Development Program	500	500						
	Sub-total Development Projects	<u>61,463</u>	<u>61,463</u>	<u>7,017</u>	<u>736</u>	<u>109</u>	<u>109</u>	<u>0</u>	<u>0</u>
	Project Development and Support	1,006	1,006	334					
	Operating Expenses	3,281	3,281	2,276					
	Emergency Rehabilitation of Chorrillo Apartments	2,500	2,500						
		<u>420,000</u>	<u>420,000</u>	<u>147,377</u>	<u>736</u>	<u>139,074</u>	<u>122,357</u>	<u>3</u>	<u>16,714</u>
Supplemental Information:									
	Interest Earned					2,015		2,015	
	ICD Recovered					5,928		5,928	
	Purchased of ICD from the separate account of reflows at the BNP						1,485	0	
	Total Cash in Banks (Federal Reserve Bank N.Y and National Bank of Panama)							(1,485)	
					<u>147,017</u>	<u>123,842</u>	<u>3</u>	<u>23,172</u>	
See notes to the fund accountability statement									

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NOTES TO THE FUND ACCOUNTABILITY STATEMENT

Note 1 Background

On May 25, 1990 under Public Law 101-302 "The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act", US \$420 million was authorized as an Economic Support Fund assistance to support Panama's economic recovery. The program includes five major categories of assistance:

- a. Cash transfer assistance for repayment of Government of Panama's (GOP) debt in arrears, budget support to the GOP's 1990-91 Public Investment Budget and to provide standby immediate liquidity to the banking system.
- b. Disbursement over a longer term development projects in support of social activities, democratic initiatives and economic policy reforms.
- c. Disbursements under the emergency and immediate recovery phases of assistance to Panama.
- d. Disbursements to repay A.I.D.'s Office of Foreign Disaster Assistance (OFDA) funds for housing rehabilitation activities under de emergency phase of the assistance.
- e. Disbursements of funds for USAID/Panama's operating expenses and the design of new projects.

Under the Economic Support Fund (ESF) Program for Panama, there are two cash transfer programs. The first, called Economic Recovery Program, has two subprograms: one for the repayment of Panama's debt arrears and the other for budget support to Panama's public

sector investment budget. The second program, called Private Sector Reactivation Program, provides added liquidity to Panama's banking system. The principal Panama Government entity involved in the Cash Transfer portion of the assistance is the National Bank of Panama (Banco Nacional de Panama - BNP).

The Economic Support Fund (ESF) Program also includes 18 development projects in the areas of training, police services, financial administration, environmental protection, private enterprise and democratic initiatives. In addition to BNP, other entities, some of which are headquartered outside Panama, will be involved in the implementation of individual Development Projects.

We have audited all the initiated activities of the programs and projects which could be audited in Panama, to the limits instructed by A.I.D. in the scope of this audit work. Such programs and projects include the the two subprograms of the Economic Recovery Program No. 525-0303; the Private Sector Reactivation Program No. 525-0304 and the Local Scholarship Project No. 525-0281.

Note 2 - Summary of Significant Accounting Policies

(a) Accounting Basis

The fund accountability statement has been prepared on the cash basis of accounting. Consequently, funding provided is recognized when received rather than when earned and expenditures are recognized when paid rather than when the obligations are incurred.

(b) Counterpart Contributions

Generally USAID grants require that implementing entities and/or the host country contribute a defined amount of assistance (which may be in-kind) to the projects. The fund accountability statement does not include this assistance (counterpart contribution), in compliance with the guidelines for Financial Audits Contracted by A.I.D.

(c) Interest Receivable

As of September 30, 1991 the Separate Bank Account of Reflows of the Private Sector Reactivation Program (525-0304) maintained at the National Bank of Panama, had accrued interest receivable earned

on such interest bearing account for the amount of US \$53,185. Such interest receivable is not included in the fund accountability statement as BNP has not cashed the interests and no payment date has been agreed with the National Bank of Panama.

(d) Monetary Unit

The accounts of the entities are maintained in the Balboa (B/.) currency of the Republic of Panama which is at par and freely exchangeable with the United States Dollar (US \$). The Republic of Panama does not issue paper currency, and in lieu, the US Dollar is used as a legal tender.

Note 3 - Questionable Costs

According to A.I.D. applicable regulations, costs charged to projects must meet the following general criteria:

- a. **Reasonable**: Shall mean those costs that do not exceed those which would be incurred by an ordinarily prudent person in the conduct of normal business.
- b. **Allocable Costs**: Shall mean those costs which are necessary to the grant.
- c. **Allowable Costs**: Shall mean those costs which must conform to any limitations set forth in the grant.

Financial audit standards require questioned cost be presented in the fund accountability statement in two separate categories (1) "questioned" costs that are explicitly ineligible because they are not program related, unreasonable, or prohibited by the agreement or applicable laws and regulations, and (2) "unsupported" costs that are not supported with adequate documentation or did not have required prior approvals or authorizations.

The following are ineligible costs paid under this program that were determined to be questionable because they did not conform with the terms of the Implementing Entity's Operations Manual:

PRIVATE SECTOR REACTIVATION PROGRAM (USAID 525-0304)

National Bank of Panama

Debit Notes corresponding to telex charges and other expenses for a total amount of US \$2,886, that were paid in excess of the approved budget, according to the Operations Manual and Program Implementation Letter No. 6.

Note 4-Private Sector Reactivation Program

The purpose of the Private Sector Reactivation Program is to assist the Government of Panama to support credit expansion by the private banking system in Panama.

In accordance with this objective, the program will provide the general license banks with funds so they can perform incremental lending activities to the productive private sector. This is to be implemented through the purchase by the National Bank of Panama (BNP) of Interbank Certificates of Deposits (ICD) from the Participating Banks (PB), equal to one half of the value of the actual new medium and long term credit, extended by the PBs.

In the USAID/Panama Program Assistance Approval Document (PAAD) prepared for the Private Sector Reactivation Program, which is the design document outlining the terms of the program, the program description indicated that those "Banks that plan to expand their medium and long term loan portfolio (loans between one and five years) will submit to the BNP a description of the new loans that they plan to make within the next 30 days".

Textually, the program's Agreement in its Annex-Program Description Section B-2-c indicates that "Banks that plan to expand their medium and long term portfolio (loans between one and five years) may submit to the BNP a description of such incremental lending that they plan to make in the next thirty days...". "...If the proposed increase in medium and long term portfolio meet the

requirements of the program, BNP will agree to purchase Interbank Certificates of Deposits (ICD)...".

According to the Agreement, the purchase of ICDs would take place after the PBs submits documentation evidencing the actual increase in the medium and long term lending, with a certification that it conforms to the criteria established for the program.

During the program execution, the word "may", used in the final text of the agreement when referring to the submission of a description of the increase in the loan portfolio, was interpreted by the implementing entity and USAID/Panama as non-binding. Consequently, the PBs were not required to present the proposed increase in their loan portfolio for the next thirty days. All ICDs were purchased after the PBs submitted the documentation of their actual new loans with the certification requested by the agreement.

The text of the Agreement does not mention which is the effective date or the cut-off date for the consideration of new loans or new loan portfolio of the PBs. However, the Operations Manual, prepared by the Program Management Unit (PMU) at BNP and authorized for use by USAID/Panama, in its Section 2.2, indicates that all resources of new loans granted by PBs within the Private Sector Reactivation Program are to be used for the financing of investment projects to be physically executed after the date of signature of the Agreement between USAID/Panama and the Government of Panama (July 24, 1990).

The Agreement contains some criteria regarding the basis for the participation of banks and credit expansion. The criteria for participating banks provided (emphasis added):

"...Before entering into any transaction under the program, the participating banks (PBs) will sign the legal documents designed by the GOP for participating in this program and will adhere to the regulations laid out in the corresponding Operations Manual...".

Using the various dates that PBs agreed with BNP their participation in this program, it was determined that US \$21.6 million of ICDs were purchased based on loan documentation dated prior to the PBs dates of agreement with the BNP.

Whether the above criteria constitutes the eligibility date cannot presently be determined by us and is a matter which must ultimately be determined by the Governments of the United States of America and The Republic of Panama.

Note 5- Event (Unaudited) Subsequent to the Date of the Independent Auditors' Report

Our audit of the Private Sector Reactivation Program included the examination of all the documentation submitted to the Implementing Entity by the Participating Banks. As limited by our scope of work, we did not examine any documentation at the Participating Banks for ensuring that appropriated funds were used as intended. However, through a letter dated November 1, 1991 addressed to USAID/Panama, the Minister of Planning and Economic Policy of Panama, indicated that after a review of the supporting loan documentation made by the National Banking Commission (the official Supervisory Entity of the Panamanian Banking System) at 14 of the 17 Participating Banks, some loans were disqualified for not being in compliance with the objectives of the program. During the month of November a total amount of US \$5,071,947 was reimbursed by two Participating Banks to the Separate Bank Account of Reflows at BNP in this respect.

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INTERNAL CONTROL STRUCTURE

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying fund accountability statement for the local execution of the USAID/Economic Support Fund (ESF) Program for Panama funded under Public Law 101-32 "The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act" for the period May 25, 1990 through September 30, 1991 and we have issued our report thereon dated October 11, 1991.

We conducted our audit in accordance with generally accepted auditing standards and the standards for financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States (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 of the above indicated Program for the period May 25, 1990 through September 30, 1991, we considered the internal control structure applied to the Program in order to determine our auditing procedures for the purpose of expressing an opinion on the fund accountability statement, and not to provide assurance on the internal control structure.

The managements of the implementing entities are responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure's 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 financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in the 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 risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures under the following categories: a) accounting and budgetary control system; b) cash management; c) management information system; and d) procurement of goods and services.

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.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under the Statement of Auditing Standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the fund accountability statement. The reportable conditions noted, are described under findings Nos. 1 to 6 in the following pages.

A material weakness is a reportable condition in which the design or operation of one or more of the 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 period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended for the information of the Government of Panama, the program implementing entities and the U.S. Agency for International Development. This restriction is not intended to limit distribution of this report which, upon acceptance by the office of the Regional Inspector General, is a matter of public record.

KPMG Peat Marwick

October 11, 1991 except for Note 5 as to
which the date is November 18, 1991

**FINANCIAL AUDIT FOR THE LOCAL EXECUTION OF THE
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REPORT ON INTERNAL CONTROL STRUCTURE

FINDINGS

**PRIVATE SECTOR REACTIVATION PROGRAM (USAID 525-0304) -
National Bank of Panama.**

- 1. The Implementing Entity for the Private Sector
Reactivation Program has not issued written job
descriptions.**

Condition:

There is no formal method to communicate to the entity's
personnel their responsibilities.

Criteria:

Responsibilities should be clearly defined in writing and
communicated as appropriate.

Cause:

As there are only few people involved in the management of this
program, the Implementing Entity did not consider necessary a
written document such as a job description.

Effect:

Considering that changes within the personnel may occur, the
inherent responsibilities of each individual within the
organization, may be ineffective due to the lack of written job
descriptions.

Recommendation:

We recommend the use of a formal method (in writing) for documenting and communicating job descriptions defining the lines of authority and responsibilities of each individual.

2. **The evaluation of the participating bank's net worth level, applied under the program was inadequately documented.**

Condition:

During the execution of the program, the Implementing Entity has not obtained official information about the net worth of the Participating Banks to allow an appropriately documented assessment of each bank's monetary participation, in accordance with the limits set forth by the agreement.

Criteria:

The section B.2.e of the description of the program, amended later by the Program Implementation Letter No. 5, limits the participation of banks, to two times their net worth.

Cause:

The Implementing Entity alleges that this information can not be obtained officially through the National Banking Commission because Panamanian banking law prohibits the disclosure of data concerning the banks.

Effect:

The lack of this documentation in the Implementing Entity's files does not allow an audit review of the appropriateness of the evaluation of the bank's net worth. Inappropriate evaluation of bank's net worth, could result in ineligible disbursements that might affect the recovery of the program's funds.

Recommendation:

The Implementing Entity should coordinate and establish a system that allows support to the Program Management Unit in

order to obtain through official means all the information required by the grant agreement.

3. **Dates of certain loans on which the placing of ICDs were based, were prior to the effective date of the agreement, which make them ineligible as credit expansion loans.**

Condition:

Documentation which supports the purchase of some Interbank Certificates of Deposits submitted to the Implementing Entity, indicates that certain loans granted by the Participating Banks were prior to the effective date of the agreement.

Criteria:

The purpose of the grant is to support credit expansion by the private banking system. According to the Operations Manual prepared by the Program Management Unit (PMU) at the BNP and authorized for use by USAID/Panama, in its Section 2.2 indicates that all resources of new loans granted by PBs, were to be physically executed after the date of the signature of the Agreement between USAID and the Government of Panama (July 24, 1990).

Cause:

The Implementing Entity inadvertently oversighted the information related to the dates of granting of some loans in the documentation submitted by some Participating Banks.

Effect:

At a first instance this situation was evaluated by us as an event of non-compliance with the terms of the agreement, which originally resulted in a total amount of US \$98,730 of questionable costs. Nevertheless, as a result of our finding the Implementing Entity contacted the affected participating banks questioning this matter. In return, new documentation was obtained by BNP supporting the issue that dates were mistakenly written down by the Participating Banks in the applications for CDs submitted for consideration to the BNP and that the correct dates for the

granting of loans were subsequent to the date of the signature of the agreement.

Recommendation:

Since the aforementioned situation was properly cleared out by the Participating Banks and the Implementing Entity, no recommendation is suggested.

4. **Some Interbank Certificates of Deposits were placed for periods longer than those established by the Implementing Entity's Operations Manual.**

Condition:

Some Interbank Certificates of Deposits purchased, related specifically to working capital loans, were placed for periods longer than 18 months, contrary to the time limit established in the BNP's Operations Manual prepared by the Program Management Unit. However, this occurred in very few cases, with no material effect in the recoverability of the ICDs.

Criteria:

The BNP's Operations Manual, in its Section B-5-g, establishes that Interbank Certificates of Deposits to be purchased based on working capital loans, should be placed for periods which varies from 12 to 18 months.

Cause:

At the beginning, the Implementing Entity was not fully familiarized with the contents of the Operations Manual, consequently, the above mentioned limitation was oversighted.

Effect:

The recovery of Interbank Certificates of Deposits will take more time than the specified in the Operations Manual. Nevertheless, this situation does not contravene the dispositions of the agreement regarding the time limits on these transactions.

Recommendation:

Since these cases occurred at the beginning of the operation of the program and corrective action was taken by the Implementing Entity to promote awareness of the situation among the personnel, no recommendation is suggested.

LOCAL SCHOLARSHIP PROJECT(USAID 525-0281)-National Foundation for Panamanian Rural Youth.

5. The National Foundation for Panamanian Rural Youth has not allocated indirect follow-up cost among the two scholarship plans.

Condition:

The National Foundation for Panamanian Rural Youth has not established adequate procedures to allocate indirect follow-up cost among the two scholarship plans presently in execution.

Criteria:

Adequate policies to distribute follow-up costs as they are disbursed, should help PANAJURU in determining expenses incurred on each of the scholarship plans, specially those conforming Program 525-0281 (Plan C).

Cause:

Management was not aware of the need for establishing formal methods to proportionally distribute the indirect follow-up cost among different scholarship plans.

Effect:

The lack of distribution of indirect follow-up cost among the existing scholarship plans, will produce incomplete information on each plan.

Recommendation:

The proportional distribution of indirect follow-up cost among the existing scholarship plans is recommended.

6. PANAJURU has not issued written job descriptions.

Condition:

There is no formal method to communicate to the entity's personnel their responsibilities.

Criteria:

Responsibilities should be clearly defined in writing and communicated as appropriate.

Cause:

As there are only few people involved in the management of this program, PANAJURU did not consider necessary a written document for communicating job descriptions.

Effect:

Considering that changes within de personnel may occur, the inherent responsibilities of each individual within the organization may be ineffective due to the lack of written job descriptions.

Recommendation:

We recommend the use of a formal method (in writing) for documenting and communicating job descriptions defining the lines of authority and responsibilities of each individual.

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**COMPLIANCE WITH AGREEMENTS TERMS AND
APPLICABLE LAWS AND REGULATIONS**

INDEPENDENT AUDITORS' REPORT

We have audited the fund accountability statement of the USAID/Economic Support Fund (ESF) Program for Panama funded under Public Law 101-302 "The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act" for the period May 25, 1990 through September 30, 1991 and we have issued our report thereon dated October 11, 1991.

We conducted our audit in accordance with generally accepted auditing standards and the Government Auditing Standards issued by the Comptroller General of the United States (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.

Compliance with laws, regulations, contract or grant applicable to the USAID/Economic Support Fund Program for Panama is the responsibility of the Government of Panama and the managements of the implementing entities involved in the Program. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the fund accountability statement. As part of obtaining reasonable assurance about whether the fund accountability statement is free of material misstatement, we performed tests of the Government of Panama and implementing units' compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on the overall compliance with such provisions.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in statutes, regulations, contracts, or grants that would cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the fund accountability statement. The results of our tests of compliance disclosed the material instances of noncompliance disclosed in findings 1 to 4 of this section.

We considered these material instances of noncompliance in forming our opinion on whether the fund accountability statement of the USAID/Economic Support Fund (ESF) Program for Panama, funded under Public Law 101-302 "The Fiscal Year 1990 Dire Emergency Supplemental Appropriation Act" for the period May 25, 1990 through September 30, 1991 is presented fairly, in all material respects, in conformity with the basis of accounting used, and this report does not affect our report dated October 11, 1991.

Except as described in the fourth paragraph, the results of our tests of compliance indicate that, with respect to the items tested, the Government of Panama and the implementing entities involved in the program complied, in all material respects, with the provisions of applicable laws and regulations referred to in the third paragraph of this report, and with respect to items not tested, nothing came to our attention that caused us to believe that the Government of Panama and the implementing entities involved with the program had not complied, in all material respects, with those provisions.

This report is intended for the information of the Government of Panama, the program implementing entities and the U.S. Agency for International Development. This restriction is not intended to limit distribution of this report which, upon acceptance by the office of the Regional Inspector General, is a matter of public record.

KPMG Peat Marwick

October 11, 1991 except for Note 5 as to
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FISCAL YEAR 1990
USAID/ECONOMIC SUPPORT FUND (ESF) PROGRAM FOR
PANAMA FOR THE PERIOD
MAY 25, 1990 THROUGH SEPTEMBER 30, 1991**

**REPORT ON COMPLIANCE WITH AGREEMENT TERMS
AND APPLICABLE LAWS AND REGULATIONS**

FINDINGS

**PRIVATE SECTOR REACTIVATION PROGRAM (USAID 525-0304) -
National Bank of Panama.**

- 1. A transfer of funds went from the Separate Account (Federal Reserve Bank) to an intermediate account other than a commingled account (as required by the Agreement) of a Participating Bank.**

Condition:

On August 28, 1991 the International Department, a support unit to the Program Management Unit, gave instructions for the transfer of funds for the amount of US \$250,000 from the Separate Account (Federal Reserve Bank) to an intermediate account other than a commingled account, as required by the agreement, of a Participating Bank. Nevertheless, this cash transfer was just transitory.

Criteria:

Section B.2.c of the Program Description states: "Upon instructions from the National Bank of Panama, funds will flow directly from the Separate Account (Federal Reserve Bank) to a commingled account of the Participating Bank or to a commingled account that the Participating Bank has in the US with a private bank. Funds from this separate account will not be placed in an intermediate account".

Cause:

Instructions were given by the Program Management Unit to make a cash transfer to a participating bank account. By mistake the value date of the transfer was incorrect and the Federal Reserve Bank did not process the cash transfer. In order to honor the commitment with the participating bank, the International Department decided to use the funds of another bank account of BNP. Few days later, this intermediate account of BNP was reimbursed with funds of the Separate Account from the Federal Reserve Bank.

Effect:

Non-compliance with section B.2.c of the agreement 525-0304. The use of an intermediate account may cause problems to USAID/Panama in monitoring cash transactions since they may need to track the transfers through other bank accounts.

Recommendation:

This was considered to be an isolated case. The support department was notified its action caused an event of non-compliance and follow up action was taken in order to avoid this happens again. No recommendation is suggested.

2. **The Implementing Entity did not comply with the submission to the USAID/Panama of the monthly statements of cash receipts and disbursements of the Separate Account.**

Condition:

Since the beginning of the activities and until August, 1991, the Implementing Entity did not comply with the submission to USAID/Panama of the monthly statements of cash receipts and disbursements of the separate account, held at the National Bank of Panama.

Criteria:

Project Implementation Letter (PIL) No. 1 requires the Implementing Entity to provide USAID/Panama with a

monthly bank statement of the Separate Account at the National Bank of Panama.

Cause:

The Implementing Entity was not aware of this program requirement.

Effect:

Non-compliance with Project Implementation Letter (PIL) No.1 of agreement 525-0304. In addition USAID/Panama could not adequately monitor the cash balances of this account due to the omission of these statements.

Recommendation:

Due to the fact that after having knowledge of the requirement of submission of such report, the Implementing Entity has consistently complied with this requirement. No recommendation is suggested.

LOCAL SCHOLARSHIP PROJECT (USAID 525-0281) - National Foundation for Panamanian Rural Youth.

- 3. The entity has not established procedures to review and guarantee proper control and recording of their counterpart contribution according to the project's budget.**

Condition:

The entity has not established procedures to review and guarantee proper control and recording of their counterpart contribution according to the project's budget. Even though the counterpart contribution is being executed, it has not been recorded and controlled in the books.

Criteria:

Under the terms of this agreement the implementing entity must establish appropriate controls of the counterpart contribution to the project.

Cause:

The terms of the grant agreement in relation to the accountability of the counterpart contribution were misunderstood by the Implementing Entity of the project.

Effect:

PANAJURU has not recorded the in-kind contribution during this phase of the project making it impossible to assess the appropriate accountability of these costs, considered in the original budget of the project.

Recommendation:

We recommend the establishment of proper procedures to follow-up on the control and recording of counterpart contributions, for the project execution.

4. Due to delays in obtaining reimbursement of expenses paid, the implementing entity has confronted liquidity problems for achieving project's goals.

Condition:

PANAJURU works the project through an advance and reimbursement method. Due to delays in obtaining reimbursement of expenses paid, the implementing entity has confronted problems in remitting timely the corresponding funds to rural schools. This situation may adversely affect the achievement of project's goals.

Criteria:

PANAJURU needs a constant cash in-flow to meet its monetary obligations in order to achieve all established goals.

Cause:

USAID/Panama centralizes all its activities through its office in Costa Rica, and makes all reimbursements by checks drawn against banks located outside the Republic of Panama. In

addition to the time needed by USAID/Panama to complete the process of the reimbursement request, for the compensation of these checks PANAJURU needs twenty one more workable days to have the funds available for remittance to the schools.

Effect:

The time elapsed from the date PANAJURU submits the reimbursement application (Form W-245) and the date the checks are cashed is considered too long. These funds are basically used by rural schools to provide food to students under the scholarship program.

Recommendation:

We recommend a meeting between PANAJURU and USAID/Panama's project officers to find out solutions to this matter in order to have the funds available to these rural schools in a reasonable period of time.

**FINANCIAL AUDIT FOR THE LOCAL EXECUTION OF THE
FISCAL YEAR 1990
USAID/ECONOMIC SUPPORT FUND (ESF) PROGRAM FOR
PANAMA FOR THE PERIOD
MAY 25, 1990 THROUGH SEPTEMBER 30, 1991**

LIST OF REPORT RECOMMENDATIONS

INTERNAL CONTROL STRUCTURE

Recommendation 1:

We recommend the use of a formal methods (in writing) for communicating job descriptions that define the lines of authority and responsibilities of each individual in the execution of the program.

Recommendation 2:

The Implementing Entity should coordinate and establish a system that allows support to the Program Management Unit in order to obtain through official means all the information required by the grant agreement.

Recommendation 3:

This situation is considered to be properly cleared out. No recommendation is suggested.

Recommendation 4:

Since these cases were encountered at the beginning of the execution of the program and corrective action was taken by the Implementing Entity to promote awareness of the situation among the personnel, no recommendation is suggested.

Recommendation 5:

The proportional distribution of indirect follow-up cost among the existing scholarship plans is recommended.

Recommendation 6:

We recommend the use of formal methods (in writing) for documenting and communicating job descriptions defining the lines of authority and responsibilities of each individual.

COMPLIANCE WITH AGREEMENTS TERMS AND APPLICABLE LAWS AND REGULATIONS

Recommendation 1:

This was considered to be an isolated case. The support department was notified of this event of non-compliance and corrective action was taken in order to avoid this happens again. No recommendation is suggested.

Recommendation 2:

Due to the fact that after having knowledge of the requirement of submission of such report, the implementing entity has consistently complied with this requirement. No recommendation is suggested.

Recommendation 3:

We recommend the establishment of proper procedures to follow-up on the control and recording of counterpart contributions, for the project execution.

Recommendation 4:

We recommend a meeting between PANAJURU and USAID/Panama's project officers to find out solutions in order to have the funds available to these rural schools in a reasonable period of time.

MANAGEMENT COMMENTS

Letterhead of Banco Nacional de Panama
FREE ENGLISH TRANSLATION

January 13, 1992

Sirs
KPMG PEAT MARWICK
City

Attention: Lic. Héctor Castillo
Partner

Dear Sirs:

This letter serves to communicate to you our comments and remarks, on the audit report of the Program for the Private Sector Reactivation (525-0304), to the extent it concerns the responsibilities of Banco Nacional de Panama (BNP) within this program.

- 1 - In your note 2.-"Significant Accounting Policies" in its letter (c) Interest Receivable, since November 1, 1991, we have placed a time deposit (230-02) to the name of the Program, where all repayments from the banks are capitalized, generating interests on the daily balances.
- 2 - In note 3.-Questionable cost, in its final part, you mention the amount of B/. 2,886.00 as telexes paid in excess due to the transfer of funds.

At the beginning of the Program it was not clearly established, if included in the annual payment of B/. 70,000.00 to Banco Nacional de Panamá for its services as financing agent, this cost was included, however this was corrected later and the journal entries were reversed as of November 14, 1991, normalizing this involuntarily produced situation.

- 3 - Within Program 525-0304, to the Banco Nacional de Panama it was assigned the specific roll of acting as Financing Agent as stipulated and detailed in the Grant Agreement and the Operations Manual. This is a partial roll in the scope of the global context of the Program. Therefore, an audit of the Administrative Unit or the Program Management Unit PMU/BNP, do not necessarily represents the whole management of the Program, and therefore, your results (of the audit) would be equally partial and in some instances could (involuntarily) be twisted.
- 4 - In reference to the preceding point and considering this particular mission of your Firm, as an audit of the performance of the PMU of BNP, it looks to us that some aspects included in you report are out of context, as they deal or include matters beyond the responsibility (and the knowledge) of BNP. Among these we must mention the following:
- a) In note No. 4, you make reference to a "Program Assistance Approval Document" (PAAD), that knowingly, is an USAID internal document, about which BNP has no knowledge neither participation. We can hardly take responsibility for such, even supposing that this was the case, we understand that the PAAD is not a document of contractual nature and therefore, what prevails is, what is written and signed in the Grant Agreement No. 525-0304 and in the corresponding Implementation Letters.
 - b) At the end of the same Note 4, reference is made to the criteria used to determine the eligibility date of the banks for their participation in the Program and you indicate, that you cannot render an opinion to this and leave this matter to the consideration of both Governments. To this respect Banco Nacional de Panamá (BNP) do not have the faculty to issue and opinion on this matter (raised by you) noting, nevertheless, that the access of the banks to the Program, was clearly defined in the Disposition II.2.1 of the Operations Manual (Page No. 21). According to this disposition, it is understood that, all general licence banks were formally empowered since the date of signature of the Agreement (July 24 ,1990) to participate in the Program. Consequently, there is no justification to the opinion or statement that the \$21.6 million were given prior to the

date of habilitation of the banks because the first transaction for the Program took place on September 27, 1990.

5 - In connection to the findings on the Internal Control Structure of the Program management unit/Banco Nacional de Panama, this are our comments, in the same order in which they are presented by you:

5.1) We accept that the personnel's duties that work in the Unit were not written in a document and we have proceeded to do it according to your recommendations. We have in our control the respective forms duly completed for the description of duties and presently they are being reviewed.

5.2) Since the beginning, first, the PMU/BNP has had the information on the paid-in capital or assigned; and on the net worth of the banks subsequently, which is basically intended to assign to each bank its "reservation or share", so that they could be guaranteed with a proper distribution of the financial resources of the Program.

It is not intended to evaluate such net worth, as is interpreted in your report, as this a duty or permanent responsibility of the National Banking Commission CBN. It is intended, to our concern, that each bank is kept within its "share".

This matter of the net worth was consolidated with the National Banking Commission, through a mechanism that, nevertheless indirectly, fulfills the legal formalities and those of the Program.

5.3) We accept that an involuntary error made by us, in the filing of the corrected documentation or the replaced documentation, led to the appreciation originally contained in your report.

5.4) We accept your remarks and we can affirm that this was amended through the "Memory Help" of March 27 1991.

- 6- In connection to the findings on the Compliance with the Dispositions of the Agreement and Applicable Regulations, these are our comments, in the same order presented by you:

6.1) It is true, that the description of the Program in its section B2c; establishes that the transfers of funds must be made from the separate account of the Federal Reserve Bank, to the account of the participating bank with its corresponsal, but in this case you point out, that because of an involuntary error in a support unit of the BNP to the Program, the effective date of the transaction was mistaken and the Federal Reserve Bank notified us of such and precisely, knowing the importance of this transaction and what the Program estipulates, such unit proceeded to make the transaction through an alternative way to comply with what it requires and credit, at the effective date indicated, the funds to the participating bank.

Notwithstanthing, we want to mention, as you do, that this was someting transitory and out of the many transactions processed by such unit, this is the only and last transaction that could originate a questioning.

- 6.2) Indeed it was not until August of 1991 when it was proceeded to send within the monthly reports, the information on the account of reflows; but we do want to point out the following.

The account of reflows was activated with the first installment payment or repayment and this situation originated in December 1990, from then on we were presenting it in the quarterly reports of our balance sheet.

We appreciate your remarks in the performance of the audit to the Program and after the corrections made, we trust in the execution of all controls to assure the adequate compliance with it.

Truly yours,

Ernesto Nicholson
Executive Manager

Virgilio Castillo
Executive Manager

APPENDIX

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