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Regional Inspector General for Audit
Tegucigalpa, Honduras

Audit of Selected Aspects of USAID/Peru's Public Law 480, Title I Program

Audit Report No. 1-527-93-001
October 30, 1992

INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Regional Inspector General for Audit
Tegucigalpa, Honduras

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CARIBBEAN SEA
N
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ATLANTIC OCEAN
PACIFIC OCEAN
RIO DE JANEIRO
SAO PAULO
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Montevideo
FALKLAND ISLANDS
Stanley
PERU
AREA Sq. Kms. 1.3 Million
POPULATION 17 Million
TITLE I PROGRAM $20 Million

U. S. MAILING ADDRESS:
RIG/T
APO. MIAMI 34022

AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA - HONDURAS

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October 30, 1992

MEMORANDUM

TO: D/USAID/Peru, Craig Buck

FROM: RIG/A/T, Lou Mundy Lou Mundy

SUBJECT: Audit of Selected Aspects of the Public Law 480 Title I Program at USAID/Peru

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of selected aspects of USAID/Peru's Public Law 480, Title I Program. The final audit report is being transmitted to you.

In preparing this report we reviewed your comments on the draft report and included them as Appendix II. The report contains no recommendations. I appreciate the cooperation and assistance provided my staff during the audit.

Background

The Federal Managers' Financial Integrity Act of 1982 requires A.I.D. to establish internal controls over its Public Law 480, Title I (Title I) Program. These controls represent the policies and procedures used by USAID/Peru to ensure that its Title I Program is effectively and efficiently managed in accordance with applicable laws and regulations. One objective of these controls is to provide reasonable assurance that revenue and expenditures are accounted for properly.

On August 31, 1990, the United States agreed to sell 155,000 metric tons of wheat valued at $ 20 million dollars to the Peruvian Government under the Title I Program. In accordance with the Title I Agreement and the Memorandum of Understanding dated August 31, 1990, the Government of Peru agreed to deposit proceeds from the sale of the wheat into a special account at Peru's National Bank. In no case was the deposited amounts to be less than the free along side value of the wheat. This value being the cost of the wheat at the point of delivery along side the boat designated to transport the wheat from the U.S. to Peru.

It was also agreed that revenue from the sale of the wheat, equivalent to $20 million would be programmed by mutual agreement to provide local currency contributions to finance: (i) Peruvian economic development and training projects supported by A.I.D., (ii) projects supporting achievement of the self-help measures in the Title I Agreement, and (iii) other development projects supported by Peru.

This audit focused only on those internal controls systems necessary to ensure that revenue generated from the sale of commodities was deposited into a special account and respective expenditures were properly monitored. We reviewed those internal controls which were in place from March 24 to April 10, 1992. Our scope was limited to those controls because of allegations made to a U.S. Senator that the Government of Peru had not established a separate account for the revenue generated from sale proceeds nor had USAID/Peru properly monitored expenditures funded from sale proceeds.

Specifically the allegations stated that USAID/Peru did not comply with the Title I Agreement because: (i) the $20 million of sale proceeds was not deposited into a special account as required by the Title I Agreement but was instead loaned by the Mission to the Peruvian Government to finance that country's Agriculture Credit Campaign, (ii) accountability for the principal amount ($20 million) and any applicable interest was inadequate, and (iii) USAID/Peru disregarded legal counsel advice to amend the Title I Agreement to include the Agriculture Credit Campaign and thereby subject the loan to the same degree of accountability required for the Title I Program.

These allegations stemmed from two events which otherwise would not normally transpire in a Title I Program. First, U.S. dollars and not local currency was generated from the sale of the Title I commodities. Second, USAID/Peru authorized the Peruvian Government to use the U.S. dollars generated from the sales for financing a Peruvian Agrarian Bank even though the Title I Agreement did not specifically authorize such usage. Because of these events, we requested the IG/Legal Counsel's advice on the appropriateness of using Title I funds to finance the Peruvian Agrarian

Bank and USAID/Peru's decision to finance the Agrarian Bank without amending the Title I Agreement.

The IG/Legal Counsel provided the following oral comments:

- Regarding the appropriateness of using Title I funds to finance the Peruvian Agrarian Bank - Since the Peruvian Government repaid the monies due to the Title I Program, there is no legal claim warranted.

- Regarding the Mission's decision to finance the Agrarian Bank without amending the Title I Agreement - Such action was management's prerogative; however, Mission management should document the action and confirm that the decision to provide funds for the Agrarian Bank is an activity that falls within the scope of activities included in the Title I Agreement.

Audit Objectives

We audited selected systems of internal controls at USAID/Peru in accordance with generally accepted government auditing standards (see Scope and Methodology, Appendix I). Our field work was conducted at the office of USAID/Peru in Lima, Peru from March 23 to April 10, 1992, and it was designed to answer the following questions:

1. Did USAID/Peru establish and implement monitoring systems in accordance with A.I.D. policies and procedures to ensure that currency generated from the sale of Title I commodities was deposited into special accounts as required by the terms of the Title I Agreement? (See page 4.)

2. Did USAID/Peru establish and implement monitoring systems in accordance with A.I.D. policies and procedures to ensure that currency generated from the sale of Title I commodities was used according to the terms of the Title I Agreement? (See page 6.)

In answering these audit objectives, we tested whether USAID/Peru followed applicable internal control procedures. Our tests were sufficient to provide reasonable, but not absolute, assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. However, because of limited time and resources, we did not continue testing when we found that USAID/Peru followed A.I.D. procedures. Therefore, we limited our conclusions concerning positive findings to the items actually tested.

Appendix I contains a complete discussion of the scope and methodology for this audit.

Audit Findings

Did USAID/Peru establish and implement monitoring systems in accordance with A.I.D. policies and procedures to ensure that currency generated from the sale of Title I commodities was deposited into special accounts as required by the terms of the Title I Agreement?

USAID/Peru established and implemented a monitoring system in accordance with A.I.D. policies and procedures to ensure compliance to the Title I Agreement provision which required that currency generated from the sale of the commodities be deposited into a special account.

USAID/Peru Mission Order No. 500-7 dated February 1, 1989, establishes and describes the operational system for depositing host country owned local currency into special accounts. Although the currency that was generated in this particular sale transaction resulted in U.S. dollars instead of local currency, the same procedures were applied. These procedures required that USAID/Peru's Program Office monitor the deposit of sale proceeds into the special account to ensure that the full amount of currency was deposited. The same mission order requires the Mission Controller to review amounts deposited in the special accounts to ensure that they are in compliance with agreements.

The August 31, 1990 Memorandum of Understanding to the Title I Agreement states, in part, that:

> *The Government of Peru agrees to deposit the proceeds accruing from the sales of agricultural commodities covered under the Agreement into a special account in the Banco de la Nacion [National Bank]. The sales proceeds to be deposited in the Treasury special account will be equal to the gross sales proceeds received, less the actual eligible commercial expenses*

incurred and paid by ENCI[1] related to the importation and distribution of the commodities sold, such as ocean freight, insurance, port fees, etc., but shall not in any case be less than the FAS [free along side[2]] value of the commodities....

Although the FAS value was not available at USAID/Peru, we were able to conclude that the provisions of the Memorandum of Understanding were met. We did not ascertain the reasons for the non availability of the FAS value nor did we audit the sales figures and related associated costs regarding the sale of the wheat as it was outside the scope of this audit. Nonetheless, according to unaudited reports from the Peruvian wheat importing agency, the total value of the wheat at the time that it was boarded on the boat for transportation to Peru (FOB[3] value) was $19.74 million. Consequently, we used the FOB value as a parameter for ensuring that the minimum proceeds required to be deposited were in fact deposited. We ascertained that the $19.87 million deposited by ENCI into the special account was greater than the FAS value and thereby determined that compliance to the memorandum of understanding was met. This deduction was based on the fact that the FOB value is greater than the FAS value because of additional charges incurred in loading the wheat from the port unto the transporting boat. Since the $19.87 million deposited exceeded both the FOB and FAS values we concluded that the memorandum of understanding provision was met.

Our audit showed that USAID/Peru established and implemented monitoring systems to ensure that currency generated from the sale of Title I commodities was deposited into special accounts as required by the terms of the Title I Agreement. The Peruvian Wheat Importing Agency opened account 019885, a separate U.S. dollar account, on November 16, 1990, at the National Bank with a deposit of $1,033,470. At the time of our audit, a total of $19,870,951 had been deposited by the Peruvian Wheat Importing Agency and another $1,396 was deposited by the Agrarian Bank to the special account. At this time, total deposits in the special account amounted to $19,872,347. Subsequent to our audit, USAID/Peru furnished us evidence that an additional $1,303,970 was deposited into the special account on April 13, 1992. Consequently total deposits into the special account were $21,176,317.

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[1] *The Peruvian Wheat Importing Agency tasked with selling the agricultural commodities and making the deposits into the special account at the National Bank.*

[2] *The cost of the wheat at the point of delivery along side the boat designated to transport the wheat from the U.S. to Peru.*

[3] *The value of the wheat on board the boat designated to transport the wheat from the U.S. to Peru.*

However, we noted that the maximum amount that could have been deposited had not been deposited into the special account. A total of $3.1 million recognized as profit by the Peruvian Wheat Importing Agency, was not deposited into the special account. The importing agency intended to use the $3.1 million gain on the sale to offset prior nonrelated wheat transactions which had incurred losses. USAID/Peru's monitoring system had already identified this problem, and officials stated that the Controller's Office would analyze the report data.

The Mission believed that these gains should not be used to offset prior losses but should instead be deposited into the special account. Since USAID/Peru was following A.I.D procedures through its analysis and was taking corrective action, we are not making any formal recommendation on this area.

Did USAID/Peru establish and implement monitoring systems in accordance with A.I.D. policies and procedures to ensure that currency generated from the sale of Title I commodities was used according to the terms of the Title I Agreement?

USAID/Peru established and implemented a monitoring system in accordance with A.I.D. policies and procedures to ensure that Title I currency generated from the sale of commodities was used in accordance with the terms of the Title I Agreement.

USAID/Peru Mission Order No. 500-7 dated February 1, 1989, describes the operational system for monitoring host country owned local currencies programmed for project support. USAID/Peru's Program Office is responsible for the overall administration of host country owned local currency. As such, the Program Office is responsible for monitoring the budget implementation process in the Peruvian Offices of the Budget and Treasury as well as in other implementing agencies to ensure that funds are allocated to projects in the agreed upon amount and in a timely manner.

The same mission order requires the project officer, with his Peruvian counterpart, to determine the amounts of host country owned local currency that each Government of Peru entity will request from the Peruvian Budget Office. The project officer is also to monitor host country disbursements to the agreed upon projects and ensure the funds are used for approved project purposes. Finally, the mission order requires the Controller to review withdrawals/disbursements from the special account to ensure that they are in compliance with the agreements.

Paragraph B.4 of the Memorandum of Understanding dated May 3, 1989 states:

> *The United States and Peru agree that the local currency amounts from sales proceeds (equivalent at least to the FAS dollar value of commodities imported under this Agreement), and interest received for the deposit in the special account, will be used for the purposes and in the manner outlined in point 2 of the MOU.*

Point 2 states, in part, that:

> *The United States and Peru agree that proceeds accruing to Peru from the sale of commodities financed under the Sales Agreement will be programmed by mutual agreement to (a) provide local currency contributions to Peruvian economic development and training projects supported by A.I.D., (b) projects supporting achievement of the self-help measures in this agreement, and (c) finance other development projects supported by Peru.*

Account Number 182982, referred to as a bridge account, was established to receive funds deposited by Peru's Treasury to fund development projects. During the period August 1990 to February 1992, the Government of Peru deposited local currency equivalent to $14.8 million into this account. During our audit an additional $3.5 million in local currency equivalent was deposited into this account in March 1992, resulting in total deposits of $18.3 million originating from the Peruvian Treasury. USAID/Peru later furnished us evidence that an additional $1.6 million had been transferred from the special account to the bridge account as of April 30, 1992. Thus, as of April 30, 1992 total funds deposited into the bridge account amounted to $19.9 million[4].

As discussed on page 5, a total of $21.176,317 was deposited into the special account. From these deposits funds totaling $19,547,591 were withdrawn from the special account to reimburse the National Bank for a loan made to the Peruvian Government to finance the country's Agricultural Credit Campaign. Since the balance in the special account now amounted to $1,628,726 ($21,176,317 less $19,547,591) the Peruvian Government needed to make restitution for the $19,547,591 withdrawal.

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[4] *We did not verify the $3.5 million or the $1.6 million deposits to bridge account records. USAID/Peru furnished us a copy of a bridge account reconciliation statement which showed the $3.5 million was deposited. They also provided us a copy of the bridge account confirming the $1.6 million deposit. USAID/Peru officials told us they would verify these amounts.*

We verified bank statements for the bridge account and confirmed that $19,178,060 had been deposited to the bridge account during the period January 31, 1991 to April 30, 1992. According to a bank reconciliation statement prepared by the Mission, another $715,986 was also deposited into the bridge account between August 1990 and January 21, 1991, resulting in total bridge deposits of $19,894,046. Although the latter deposit was not confirmed to bank statements, our testing of the $19.18 million of the total $19.89 million (96.5 percent) provided reasonable assurances that the $715,986 was deposited to the bridge account.

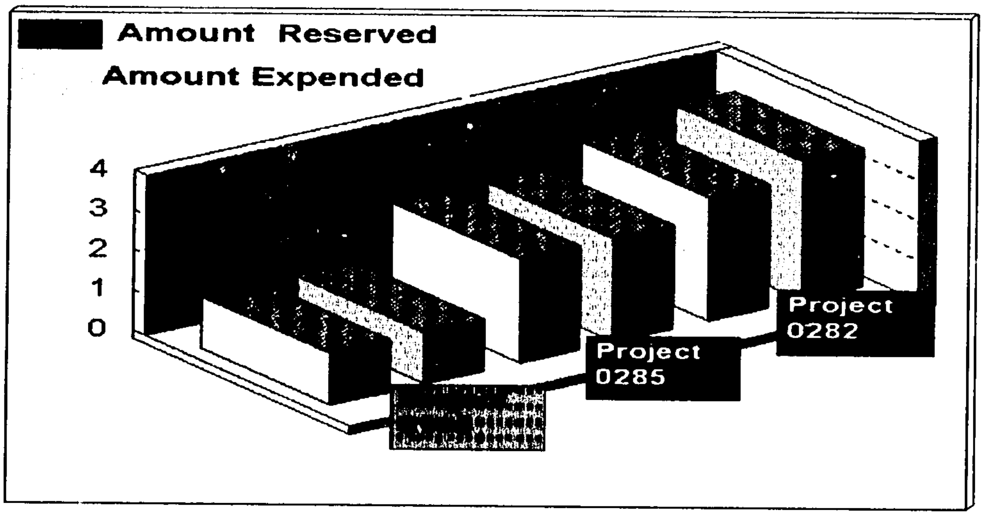
According to paragraph B.4 to the Memorandum of Understanding, the funds required to be used to finance the agreed upon development projects were to be no less than the FAS value. As previously stated on page 6, we concluded that the $19,870,951 deposited by the Importing Agency into the special account exceeded the FAS value. Since the bridge account was to fund the agreed upon development projects, and the total bridge deposits were to no less than the FAS value, the $19,870,951 deposited by the Importing Agency represents the minimum amount needed to comply with paragraph B.4 to the Memorandum of Understanding. This requirement was complied with when all of the $19,894,046 was deposited into the bridge account from the special account. At this point, all funds due the P.L. 480 Title I program were repaid.

Each development project programmed to receive funds under the Title I Agreement was assigned a subaccount under the bridge account. Designated personnel from these projects were authorized to make withdrawals from the bridge account. They were notified by the Peruvian Ministry of Economics and Finance through "fund authorizations" of the amounts authorized for withdrawal. Then the designated personnel issued checks against their projects' respective subaccounts.

The local currency in the bridge account did not earn interest. Generally, the wheat sales would have been made in local currency and a bridge account would not have been necessary. In prior Title I Agreements the local currency proceeds from the sales were deposited in interest earning accounts until they were transferred to the projects.

We tested the Mission's stated procedures by selecting three projects to determine whether the local currency provided by the Government of Peru was being used in accordance with the Title I Agreement. We reviewed $7.4 million of the total $14.8 million that, as of February 1992, had been allocated to agreed upon projects per the Title I Agreement. This showed that USAID/Peru's monitorship system adequately ensured that the projects received the level of funding support programmed. We also visited three projects and this confirmed that they received the budget funds. The results of our review are shown in the table on page 9.

RESULTS OF REVIEW TO DETERMINE FUNDING SUPPORT TO PROJECTS
($000,000)



Project No.	Amount Reserved in Bridge Account	Amount Expended	Amount Available
0282	$3.5	$3.1	$0.4
0285	$2.6	$2.6	$0.0
0244	$1.3	$1.3	$0.0
TOTAL	$7.4	$7.0	$0.4

USAID/Peru established and implemented a monitoring system to ensure that Title I currency generated from the sale of commodities was used in accordance with the terms of the Title I Agreement. Our tests showed that funds were budgeted for agreed-upon-projects by the Government of Peru and that the projects were in fact receiving the budgeted funds. USAID/Peru had in place policies and procedures that provided reasonable assurances that projects would continue to receive programmed funds and be used for project related purposes, as required by the Title I Agreement.

SCOPE AND METHODOLOGY

Scope

We audited selected systems of internal controls pertaining to the Title I Program at USAID/Peru in accordance with generally accepted government auditing standards. We conducted the audit from March 23 to April 10, 1992, and did our field work at USAID/Peru in Lima, Peru. We visited 2 banks and 3 project sites to verify the receipt of funds disbursed to these entities by the Peruvian Government. The audit covered systems and procedures in place from March 24 to April 10, 1992. The audit entailed interviewing USAID/Peru officials, reviewing Mission files and records, and reviewing those policies and procedures necessary to determine whether USAID/Peru established and implemented policies and procedures to ensure that: (1) sales proceeds from the Title I commodities were deposited into a special account, and (2) a system was in place to monitor that Title I currency generated from the sale of commodities was used in accordance with the Title I Agreement. Our audit did not include an assessment of compliance with applicable laws and regulations as our audit objectives did not address USAID/Peru compliance.

During the period of our audit USAID/Peru's Title I Agreement, signed on August 31, 1990, was valued at approximately $ 20 million. We did not specifically audit these amounts or the allegations made concerning the Title I Program. Rather our audit focused on that part of the Program related to ensuring that sales proceeds were deposited into the special account and were used for agreed-upon-purposes. As such, we focused on the special account established to receive the proceeds from the sale of wheat valued at $20 million. At the time of our audit the account contained $19,872,347. We also looked at the bridge account established to fund the projects specified per the Title I Agreement. In this case, the account consisted of local currency equivalent to $14.8 million at the time of our audit. We did not audit sales figures and associated costs regarding the sale of the wheat as it was outside the scope of this audit. We obtained receipts from the Agrarian Bank showing that it received local currency equivalent to $20 million. However, we did not audit the Agrarian Bank for utilization of these funds.

A written representation letter was obtained from USAID/Peru attesting to the best of their knowledge and belief that: a) all essential information was provided, b) the information was accurate and complete, and c) A.I.D.'s policies were followed.

Methodology

The audit was made in accordance with generally accepted government audit standards. The methodology for each audit objective follows.

Audit Objective One

To accomplish the first audit objective, we obtained and reviewed USAID/Peru Mission Order No. 500-7 dated February 1, 1989, to determine the Mission's policies and procedures for monitoring the local currency generated from the sale of commodities. We also obtained and reviewed the August 31, 1990 Memorandum of Understanding to the Title I Agreement between the Government of the United States and the Republic of Peru to determine the criteria for the program. We interviewed operating personnel to determine the policies and procedures used to implement the criteria as cited in the Memorandum of Understanding. We also obtained a listing of the tonnage and amounts of wheat that were sold from the local wheat importing agency to determine the dollar value that should have been deposited into the special account. Subsequently, we compared and verified the deposits into the special account by obtaining and reviewing bank accounts from the National Bank. We then compared the polices and procedures in effect to Title I Section 104 and asked IG Legal Counsel for advice as to whether violations to Title I had occurred.

Audit Objective Two

To accomplish the second audit objective, we obtained and reviewed USAID/Peru Mission Order No. 500-7 dated February 1, 1989, to determine the Mission's policies and procedures for monitoring the local currency generated from the sale of commodities. We interviewed operating personnel to determine how these polices and procedures were implemented. We then determined the universe of projects and amounts budgeted under the Title 1 Agreement. We determined that at least $19,870,951 from the special account was to be budgeted and deposited into a [bridge] account for the projects specified per the Title I Agreement. We then obtained monthly bank statements for the bridge account from

September 1990 to April 1992. We reviewed the reconciliations of these monthly statements through March 1992. This review indicated that $18,265,320 had been deposited into the bridge account. We then tested 50 percent ($7.4 million) of the bridge account balance for the audit period (August 1990 to February 1992) which amounted to $14.8 million, to determine if the projects were in fact receiving the budgeted amounts as required per the Title I Agreement. We then compared the polices and procedures in effect to Title I Section 105 and asked IG Legal Counsel for advice as to whether violations to Title I had occurred.

MANAGEMENT COMMENTS

UNITED STATES GOVERNMENT

memorandum

DATE: August 28, 1992

REPLY TO ATTN OF: Craig G. Buck, USAID/Peru Director

SUBJECT: Draft Audit Report of Selected Aspects of the Public Law 480, Title I Program at USAID/Peru

TO: Mr. Lou Mundy, RIG/A/T

REF: Mundy/Buck August 7, 1992 Transmittal Memorandum received August 11, 1992

The Mission has received subject draft audit report and has no additional comments.

Attached please find Representation Letter pertaining to subject audit, which is signed by me.

The Mission Project Office continues to actively follow up to ensure that due amount is deposited into the special account. In this regard, they are in the process of verification of the amount of net sales proceeds yet to be deposited into the PL 480 Title I account. As part of this process, the Controller's Office tested approximately 50 percent of the total program reported costs as part of our verification that ENCI has reported eligible costs correctly.

We appreciate the manner in which the RIG/A/T handled this audit and their frankness concerning the allegations.

Clearance:
FAR:ATasso
FMA:JBMartin
PDP:CEspino
PDP:WEgan
ADD:RGoldman

Enc.: Representation Letter

REPORT ON INTERNAL CONTROLS

This section provides a summary of our assessment of USAID/Peru's internal controls for the areas covered by the audit objectives.

Scope of Our Internal Control Assessment

We conducted our audit in accordance with generally accepted government auditing standards which require that we:

- assess the applicable internal controls when necessary to satisfy the audit objectives, and
- report on the controls assessed, the scope of our work, and any significant weaknesses found during the audit.

We limited our assessment of internal controls to those controls applicable to the audit objectives and not to provide assurance on the auditee's overall internal control structure.

For the purposes of this report, we classified significant internal control policies and procedures applicable to each audit objective by categories. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether they had been placed in operation--and we assessed control risk. We have reported these categories as well as any significant weaknesses under the applicable audit objective in the "Conclusions for the Audit Objectives" section of this report.

General Background on Internal Controls

The management of A.I.D., including USAID/Peru, is responsible for establishing and maintaining adequate internal controls. Recognizing the need to re-emphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Managers' Financial Integrity Act (FMFIA) in September 1982. The FMFIA, which amends the Accounting and Auditing Act of 1950, makes the heads of executive agencies and other managers as delegated legally responsible for establishing and maintaining adequate internal controls. Also, the General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining such controls.

In response to the FMFIA, the Office of Management and Budget has issued guidelines for the "Evaluation and Improvement of Reporting on Internal Control Systems in the Federal Government". According to these guidelines, management is required to assess the expected benefits versus the related costs of internal control policies and procedures. The objectives of internal control policies and procedures for federal foreign assistance programs are to provide management with reasonable--but not absolute--assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether a system will work in the future is risky because changes in conditions may require additional procedures or the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusions for the Audit Objectives

Audit Objective One

The first audit objective concerns the deposit of currency accrued from the sales of Title I commodities into a special account. In planning and performing this objective we considered the Title I Agreement dated May 3, 1989, and amended on August 31, 1990; Section 105 to Public Law 480; applicable internal control policies and procedures cited in A.I.D. Handbook 9; and local Mission Order No 500-7. We classified the relevant policies and procedures into a category called the currency monitoring process.

We did not note any significant weaknesses relating to the Mission's policy and procedures regarding the establishment of a special account for sale proceeds. As part of our assessment, we reviewed USAID/Peru's internal controls relating to the deposit of currency generated from the sale of Title I commodities. Our assessment showed that USAID/Peru's controls were logically and consistently applied.

Audit Objective Two

The second audit objective relates to the accountability over the sales proceeds that were deposited into the special account. In planning and performing this objective we considered the Title I Agreement dated May 3, 1989, and amended on August 31, 1990; Section 105 to Public Law 480; applicable internal control policies and procedures cited in A.I.D. Handbook 9; and local Mission Order No 500-7. We classified the relevant policies and procedures into a category called the currency monitoring process.

We did not note any significant weaknesses relating to the Mission's policy and procedures regarding the accountability over sale proceeds. As part of our assessment, we reviewed USAID/Peru's internal controls relating to the monitorship of currency generated from the sale of Title I commodities. Our assessment showed that USAID/Peru's controls were logically and consistently applied.

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