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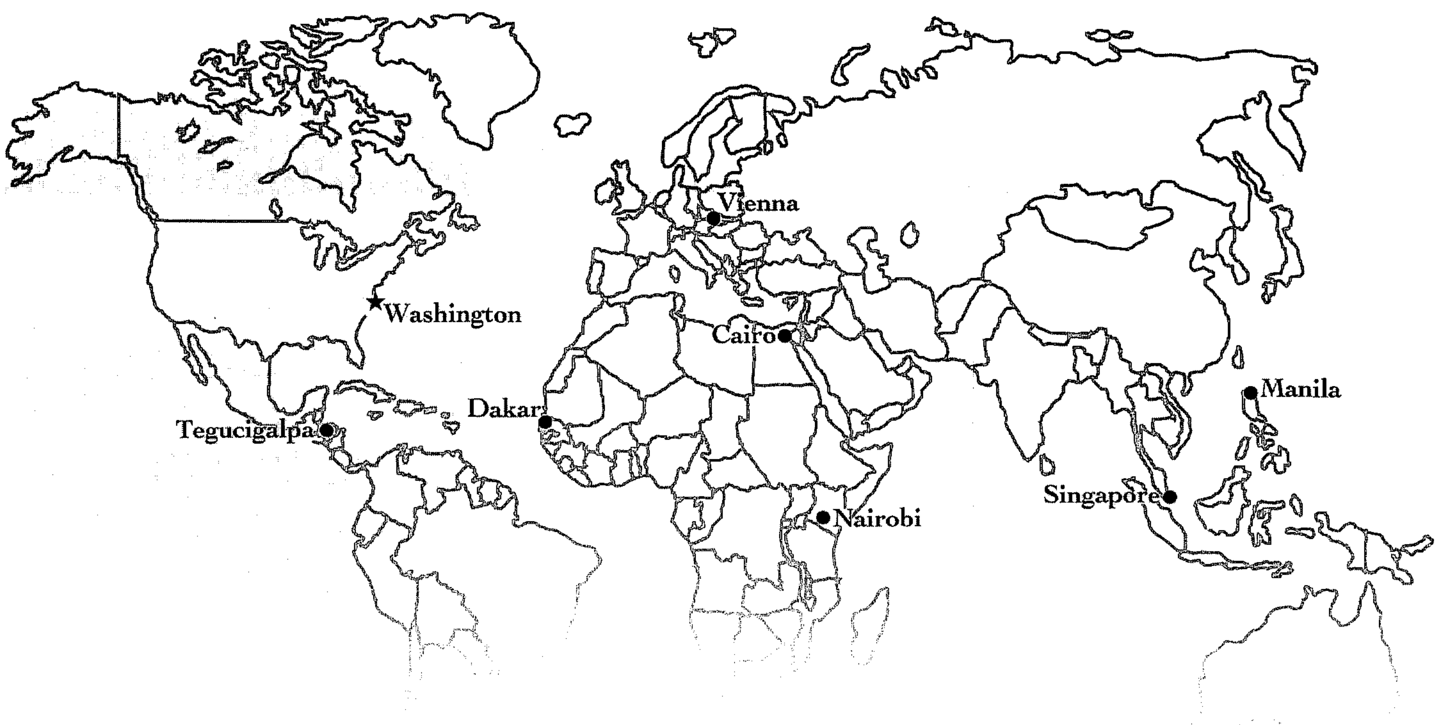
Regional Inspector General for Audit
Bonn

Audit of the Department of the Treasury's Technical Assistance Activities in Hungary and Poland

Report No. 8-180-94-009
June 29, 1994



Brian Wicklund

U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
DEICHMANNS AUE 29
53170 BONN
GERMANY

June 29, 1994

MEMORANDUM

TO: DAA/ENI, Barbara Turner

FROM: RIG/A/Bonn, John P. Competello

SUBJECT: Audit Report on the Department of the Treasury's Technical Assistance Activities in Hungary and Poland (Report No. 8-180-94-009)

This is the second of two reports we have issued on Treasury's technical assistance activities in Central and Eastern Europe. The report presents the results of our audit work in Hungary and Poland. We previously issued an audit report on Treasury's technical assistance activities in Bulgaria (A/R No. 8-183-94-003, dated February 25, 1994). We selected Bulgaria, Hungary, and Poland for audit—in consultation with Treasury—because we believe that technical assistance activities in these countries are representative of activities conducted under Treasury's regional program.

The audit found that computer software provided by Treasury to Hungary's International Training Center for Bankers, Ltd. was not being used nor had steps been taken to ensure the sustainability of Poland's Warsaw School of Banking. Responding to our audit findings and recommendations, the Department of the Treasury decided to provide additional training in using the software to staff of the Center in Hungary and assist the Warsaw School in developing a strategy for sustainability. We also found that Treasury's technical assistance activities in Hungary and Poland lacked progress indicators, making it difficult to measure results. Treasury agreed with this finding and indicated that, in cooperation with USAID, it would develop a clear and useful system of progress indicators.

With respect to USAID Representatives' oversight responsibilities for Treasury's technical assistance activities, we found that the USAID Representative in Hungary was monitoring Treasury activities and that the USAID Representative in Poland had taken steps to improve monitoring. However, we also found that the USAID Representatives in both countries lacked certain key documents needed

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for monitoring, a problem affecting USAID Representatives in all seven Central and Eastern Europe countries where Treasury is conducting technical assistance activities and the three Baltic States.

We made two recommendations to improve Treasury's technical assistance activities and one recommendation to ensure that USAID Representatives are provided information needed to carry out monitoring responsibilities. Based on your comments and those provided by the Department of the Treasury, Recommendation Nos. 1 and 2 are resolved and can be closed upon completion of planned actions. Recommendation No. 3 is unresolved until procedures are specified to ensure that USAID Representatives are provided key documents. The Recommendation can be closed when evidence is provided that the procedures have been implemented and that key documents have been supplied to USAID Representatives in the seven Central and Eastern Europe countries and the three Baltic States. Comments by the Bureau and Treasury are summarized after each audit finding and presented in their entirety as Appendices II and III, respectively.

Please provide us information within 30 days indicating any actions planned or taken to implement the recommendations. I appreciate the cooperation extended to my staff during the audit.

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EXECUTIVE SUMMARY

A large portion of funding by the U.S. Agency for International Development (USAID) for the Central and Eastern Europe program is transferred to other U.S. Government agencies. As of December 31, 1993, USAID had transferred approximately $465 million to 19 U.S. Government agencies. Of this amount, USAID had transferred approximately $43 million under interagency agreements to the Department of the Treasury to implement financial sector reform programs in seven Central and Eastern Europe countries and the three Baltic States. As of the same date, Treasury had obligated about $26.6 million under three projects for activities in the region.

We audited Treasury's technical assistance activities in three Central and Eastern Europe countries—Bulgaria, Hungary, and Poland. Treasury obligations in the three countries, totaling about $13.6 million as of December 31, 1993, represent approximately 51 percent of Treasury's total obligations for activities in Central and Eastern Europe countries and the Baltic States. Results of our work in Bulgaria were presented in an earlier audit report (A/R No. 8-183-94-003, dated February 25, 1994). This report presents the results of our audit work in Hungary and Poland and covers Treasury's obligations of about $9 million and expenditures of about $4.4 million in the two countries as of December 31, 1993. We selected Bulgaria, Hungary, and Poland for audit—in consultation with Treasury—because we believe that technical assistance activities in these countries are representative of activities conducted under Treasury's regional program.

The Office of the Regional Inspector General for Audit/Bonn audited the Department of the Treasury's technical assistance activities in Hungary and Poland to determine: (1) what USAID funds were used for and what results were being achieved in pursuit of the project purposes, and (2) whether the USAID Representatives in Hungary and Poland carried out oversight responsibilities for the Department of the Treasury interagency agreements in accordance with applicable

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legislation and internal requirements. The audit was conducted from November 9, 1993 to February 10, 1994 (see Appendix I).

As of December 31, 1993, Treasury had spent approximately $1.6 million of the $2.4 million obligated for technical assistance activities in Hungary and about $2.8 million of the $6.6 million obligated for activities in Poland. The majority of Treasury expenditures were for: (1) salaries, transportation, and support costs for long- and short-term advisers; (2) training materials provided to Hungary's International Training Center for Bankers, Ltd. under a contract between Treasury and KPMG Peat Marwick; and, (3) salaries and indirect costs associated with providing a long-term adviser and short-term instructors to Poland's Warsaw School of Banking under the KPMG Peat Marwick contract (see pages 4 and 5).

While Treasury's technical assistance activities were achieving some significant results, the audit identified areas where the activities can be improved. Specifically, the audit found that a computer software training package provided to Hungary's International Training Center for Bankers, Ltd. was not being used (see pages 9 and 10). In addition, the sustainability of Poland's Warsaw School of Banking after U.S. assistance ends was in question (see pages 10 and 11). Further, the audit found that Treasury's technical assistance activities in Hungary and Poland lacked progress indicators, making it difficult to measure results (see pages 13 to 16).

The audit also found that the USAID Representative in Hungary was carrying out oversight responsibilities for Treasury's technical assistance activities in accordance with applicable legislation and internal requirements and that the USAID Representative in Poland was taking steps to improve oversight of Treasury activities there. However, both USAID Representatives lacked key documents needed to facilitate oversight, a problem adversely affecting program management in all seven Central and Eastern Europe countries and the three Baltic States (see pages 19 to 21).

This report contains three recommendations for USAID and Treasury to: (1) involve the faculty and staff of Hungary's banker training institute in designing and delivering Treasury-funded training conducted at the institute, develop a plan for use of the $15,000 computer software provided to the institute, and develop a strategy for assisting Poland's banker training institute to become self-sufficient (see pages 8 and 9); (2) ensure that Treasury develops indicators for measuring progress and results of its technical assistance (see page 14); and, (3) ensure that USAID Representatives in Hungary and Poland are provided key documents needed to monitor Treasury's technical assistance activities (see page 19).

The Department of the Treasury agreed with our report findings and recommendations, commenting that the report makes a useful contribution to the management of its technical assistance program. Treasury indicated that actions would be taken to (1) increase the use of the computer software training program provided to Hungary's banker training institute and (2) develop a strategy to ensure the sustainability of the banker training institute in Poland after Treasury's assistance ends (see pages 12 and 13). Treasury also agreed that it needs a more systematic effort to assess progress of its assistance activities and stated that it planned to develop a clear and useful system of progress indicators (see page 16).

The Bureau for Europe and the New Independent States also concurred with the audit findings and recommendations. The Bureau, in response to our audit recommendation that actions be taken to ensure USAID Representatives are provided key documents needed to monitor Treasury's activities, indicated that key documents had been provided (see page 21). However, subsequent contact with the USAID Representative in Hungary indicated that documentation problems continue to exist. Accordingly, the recommendation is considered unresolved until the Bureau specifies the procedures that will be implemented to ensure that all USAID representatives are provided the documents needed to carry out monitoring responsibilities. The remaining recommendations are considered resolved.

Office of the Inspector General

Office of the Inspector General
June 29, 1994

Eastern Europe

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INTRODUCTION

Background

A large portion of funding by the U.S. Agency for International Development (USAID) for the Central and Eastern Europe program is transferred to other U.S. Government agencies using interagency agreements. As of December 31, 1993, USAID had transferred approximately $465 million, representing approximately 36 percent of USAID funding for the Central and Eastern Europe program, to 19 U.S. Government agencies. Of this amount, USAID transferred approximately $43 million[1] to the Department of the Treasury for technical assistance to the financial sectors of seven Central and Eastern Europe countries and three Baltic states.

Funds were transferred to Treasury under three USAID projects through interagency agreements.

- Through the Tax Policy and Tax Administration Advisory Activity of the Competition Policy, Laws and Regulations project (No. 180-0026), Treasury provides assistance in designing and implementing market-oriented tax systems.

- The Financial Adviser component of the Business Services project (No. 180-0027) provides for financial advisers to assist in the areas of economic policy, banking, and public finance to facilitate conversion to private sector-based economies.

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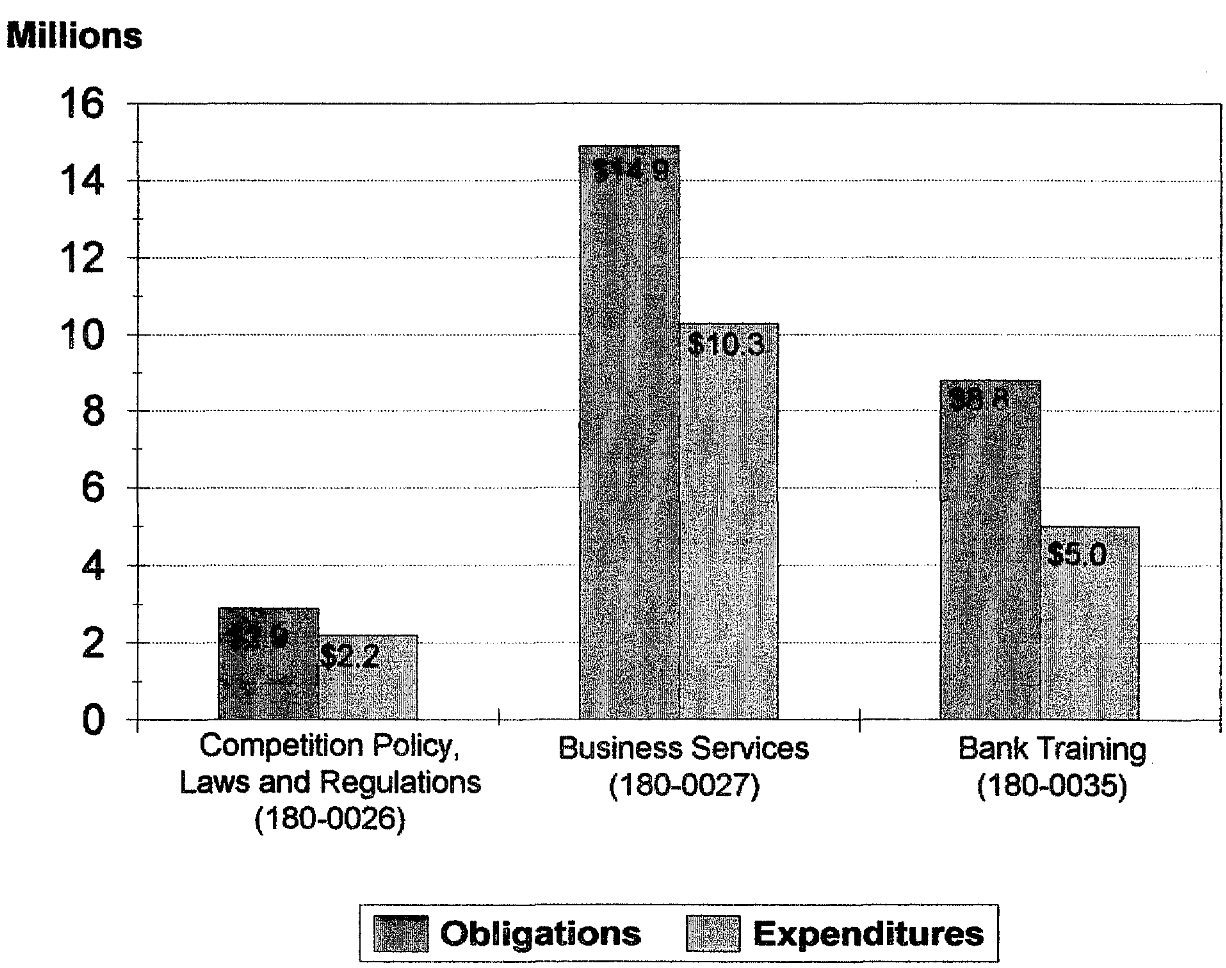
[1] *An additional $199.1 million was provided by USAID to the Department of the Treasury to establish the Polish Bank Recapitalization Fund under the Central and Eastern Europe program. The Fund is the subject of a separate audit.*

- The Bank Training project (No. 180-0035) provides for the establishment and expansion of commercial banker training institutes and augments the training capabilities of existing commercial banker training institutes.

As of December 31, 1993, Treasury obligations under the three projects in the seven Central and Eastern Europe countries and the three Baltic States were approximately $26.6 million and expenditures were about $17.5 million. The chart below shows total amounts obligated and expended by Treasury, region-wide, for each of the three projects.

TREASURY REGION-WIDE OBLIGATIONS AND EXPENDITURES AS OF DECEMBER 31, 1993



We audited Treasury's technical assistance activities in three Central and Eastern Europe countries—Bulgaria, Hungary, and Poland. Treasury obligations in the three countries totaled about $13.6 million as of December 31, 1993, and represented about 51 percent of Treasury's region-wide obligations, about $26.6 million, for activities in seven Central and Eastern Europe countries and the three Baltic States. Treasury expenditures in Bulgaria, Hungary, and Poland were about $6.8 million, as of the same date, and represented about 39 percent of Treasury's region-wide expenditures of approximately $17.5 million. We selected Bulgaria, Hungary, and Poland for audit—in consultation with Treasury—because we believe that technical assistance activities in these countries are representative of activities conducted under Treasury's regional program for seven Central and Eastern Europe countries and the three Baltic States. Results of our work in Bulgaria were presented in an earlier audit report (A/R No. 8-183-94-003, dated February 25, 1994).

This report presents the results of our audit work in Hungary and Poland and covers Treasury's obligations of about $9 million and expenditures of about $4.4 million in the two countries as of December 31, 1993.

Audit Objectives

As part of its revised fiscal year 1993 audit plan, the Office of the Regional Inspector General for Audit/Bonn audited the Department of the Treasury's technical assistance activities in Hungary and Poland to answer the following questions:

- What were USAID funds used for and what results were being achieved in relation to project purposes, as stated in the Bureau for Europe and the New Independent States' interagency agreements with the Department of the Treasury in Hungary and Poland?

- Did USAID Representatives in Hungary and Poland carry out oversight responsibilities for the Department of the Treasury interagency agreements in accordance with applicable legislation and internal requirements?

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

REPORT OF AUDIT FINDINGS

What were USAID funds used for and what results were being achieved in relation to project purposes, as stated in the Bureau for Europe and the New Independent States' interagency agreements with the Department of the Treasury in Hungary and Poland?

As of December 31, 1993, the Department of the Treasury had obligated about $9 million under three projects for technical assistance activities to assist the governments of Hungary and Poland with problems in their financial sectors. The funds had been transferred from the U.S. Agency for International Development (USAID) under interagency agreements. Since the assistance began in 1991, Treasury has spent approximately $4.4 million primarily in support of long- and short-term advisers to banks and the ministry of finance and a banker training institute in each country.

Under the Competition Policy, Laws and Regulations (180-0026) and the Business Services (180-0027) projects, USAID funds were used by Treasury primarily to pay for salaries, transportation expenses, and support costs for six long-term and 20 short-term advisers in Hungary and six long-term and 24 short-term advisers in Poland. Base salaries for the long-term advisers in Hungary ranged from approximately $77,000 to $120,000 per year. Salaries for the long-term advisers in Poland ranged from about $35,000 to $93,000 per year.

Under the Bank Training (180-0035) project, Treasury awarded KPMG Peat Marwick a competitively bid $9 million contract to provide assistance to banker training institutes located in several Central and Eastern Europe countries, including Hungary and Poland. In Hungary, the assistance was intended to augment the training capabilities of an existing banker training institute, the International Training Center for Bankers, Ltd. The assistance consisted of computer software valued at about $15,000, instruction in the use of the software, and training materials valued at about $1,000. We estimate that total expenditures in Hungary through the end of the contract with KPMG Peat Marwick, September 30, 1994, will be about $139,000.

Assistance to the banker training institute in Poland, the Warsaw School of Banking, was intended to augment the training capacity of the institute by providing a long-term adviser, short-term instructors to teach training courses, office equipment, and computer hardware and software. The long-term adviser's base salary was approximately $85,000 per year. We estimate that through the contract period ending September 30, 1994, costs associated with the long-term adviser and the short-term instructors (salaries, housing, differential, and allocated portion of the total contract) will be about $1.7 million, and the total cost of computer equipment and software provided to the institute will be approximately $43,000.

The Department of the Treasury did not maintain financial data by country for its initial interagency agreements with USAID. However, for interagency agreements signed after May 1991 and for the interagency agreement for the Bank Training (180-0035) project, Treasury did maintain such data. We estimate that, as of December 31, 1993, Treasury had spent approximately $1.6 million for activities in Hungary and about $2.8 million for activities in Poland under the three projects.

Hungarian and Polish government, USAID Representative, U.S. Embassy, and other donor officials we interviewed believed that the technical assistance provided by the Department of the Treasury's long- and short-term advisers for the Competition Policy, Laws and Regulations (180-0026) and the Business Services (180-0027) projects contributed significantly to strengthening the financial sectors in Hungary and Poland. For example,

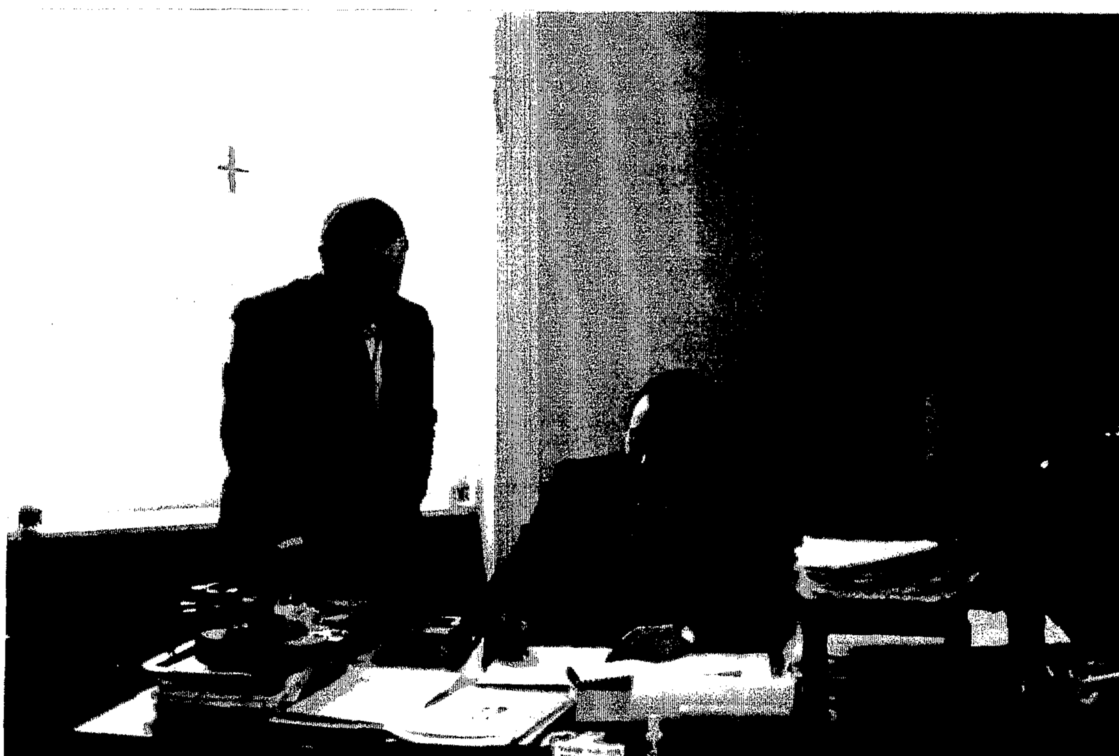
In Hungary:

- An adviser assigned to the government minister responsible for formulating privatization policy for commercial banks provided policy advice to senior-level government officials. In addition, the adviser drafted standards used to select investment banks to assist the government with commercial bank privatization.

- The adviser to the Hungarian Ministry of Finance drafted the model agreement between the Hungarian government and state-owned commercial banks outlining standards the banks must meet before government funding will be provided to resolve problem loans.

- An adviser to a state-owned commercial bank assisted in developing a strategic plan for managing the bank's problem loans. Further, to comply with World Bank lending requirements, the adviser identified debts of companies owned by the Hungarian State Holding Company.

- Advisers to two other Hungarian commercial banks assisted in strengthening the banks' credit divisions. One adviser helped establish appropriate controls for the bank's top 100 problem loan accounts; the other adviser helped organize the bank's credit assessment process.



A Treasury technical adviser (standing) provides assistance to the president of a Hungarian commercial bank in Budapest, Hungary. (December 1993)

In Poland:

- An adviser to the Ministry of Finance assisted senior-level officials in preparing for external debt negotiations and in the financial restructuring of banks and government-owned enterprises.

- Another adviser provided advice to the Ministry of Finance on negotiations to restructure Poland's external debt. He also served as liaison between the Ministry and commercial and investment banks and prepared management reports and briefing materials for negotiating sessions with Poland's external creditors.

- An adviser to a state-owned commercial bank assisted in developing a strategic plan to make the bank ready for privatization and in establishing credit administration and marketing departments within the bank. Additionally, he provided advice on credit administration, data processing, and training.

- The adviser to the National Bank of Poland provided training to bank examiners and participated in developing a manual for bank examiners.

A USAID-supported financial sector evaluation[2] concluded that the Department of the Treasury's advisers in Hungary had developed strong relationships with their recipient counterparts enabling the advisers to share their personal expertise. A similar evaluation[3] in Poland found that Treasury advisers were generally well selected and competent people who used their technical and personal skills to make positive contributions.

Our audit determined that actions were needed to improve the effectiveness of Treasury's technical assistance provided to banker training institutes in Hungary and Poland under the Bank Training (180-0035) project. In addition, while the assistance being provided by Treasury's long-term advisers under the Competition, Laws and

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[2] *"Hungary's Financial System: Status and Prospects," dated August 1993 and prepared by Development Alternatives, Inc. under the Consulting Assistance for Economic Reform subcontract (PDC-0095-Z-00-9053-12).*

[3] *"Poland's Emerging Financial System: Status and Prospects," dated August 1993 and prepared by Development Alternatives, Inc. under the Consulting Assistance for Economic Reform subcontract (PDC-0095-Z-00-9053-12).*

Regulations (180-0026) and the Business Services (180-0027) projects was well received, our audit found that the absence of progress indicators made it difficult to measure the impact and effectiveness of project activities. These problems are discussed more fully below.

Actions Are Needed to Improve Treasury
<u>Assistance to Banker Training Institutes</u>

Assistance provided by the Department of the Treasury to banker training institutes in Hungary and Poland through its contract with KPMG Peat Marwick is intended to augment the training capabilities of the institutes and ensure that they continue after U.S. Government assistance ends. We found that (1) assistance to the institute in Hungary has done little to augment the institute's capabilities, and (2) the sustainability of the institute in Poland after U.S. assistance ends is in question. These problems occurred because computer-based training materials provided to the institute in Hungary did not meet the institute's needs, and opportunities to develop the institute's faculty were missed. For the institute in Poland, Treasury did not ensure that KPMG Peat Marwick developed a strategy for assisting the institute to become self-sufficient after the Treasury assistance ends. As a result, benefits derived by Hungary's International Training Center for Bankers, Ltd. from that portion of Treasury's $9 million contract with KPMG Peat Marwick to support activities in Hungary—we estimate to be about $139,000—have been limited. In Poland, the financial viability of the Warsaw School of Banking after U.S. assistance ends has not been ensured. Thus, the intended benefits from that portion of the contract with KPMG Peat Marwick—estimated at about $1.7 million—supporting assistance to the Warsaw School of Banking may not be realized.

> <u>Recommendation No. 1:</u> **We recommend that the Bureau for Europe and the New Independent States, in consultation with the USAID Representatives in Hungary and Poland, ensure that the Department of the Treasury obtains:**
>
> **1.1 commitment from its contractor KPMG Peat Marwick to involve the Center's faculty and staff in designing and delivering Treasury-funded training programs conducted at Hungary's International Training Center for Bankers, Ltd.;**
>
> **1.2 in conjunction with Hungary's International Training Center for Bankers, Ltd., a plan for using the $15,000 computer software provided to the Center or finds alternative uses for the software; and,**

1.3 **a strategy for assisting Poland's Warsaw School of Banking to become self-sufficient, a strategy that includes self-financing plans that identify alternative funding sources and specifies procedures for recruiting and training instructors.**

The Department of the Treasury's contract with KPMG Peat Marwick calls for the contractor to provide assistance to augment the training capabilities of Hungary's International Training Center for Bankers, Ltd. and Poland's Warsaw School of Banking, and ensure that the two institutes continue after U.S. Government assistance ends. To accomplish these objectives, KPMG Peat Marwick provided computer software, instruction in using the software, and training materials to the institute in Hungary and a long-term adviser, short-term instructors, office equipment, and computer hardware and software to the institute in Poland.

Continued assistance to Hungary's International Training Center for Bankers should focus on enhancing the Center's training capabilities. Our audit found that computer software provided by KPMG Peat Marwick was doing little to enhance the capacity of the banker training institute in Hungary, the International Training Center for Bankers, Ltd., to provide training to bankers. According to institute officials, the software, provided by KPMG Peat Marwick and valued at about $15,000, has not contributed to developing the institute as a training facility. In addition, institute officials believe that KPMG Peat Marwick missed an opportunity to enhance the institute's training capacity.

In July 1991, Treasury asked the institute to identify the areas where technical assistance was needed. In response, the institute requested the "Bankexec" software package—which allows students to simulate managing a bank—and instruction in its use. KPMG Peat Marwick provided the software in September 1992 and the instruction through workshops in October 1992 and May 1993. However, during our field visit in December 1993, institute officials said they were not using the software. The officials found the software too advanced for the institute's students who, officials said, are primarily mid-level bank managers lacking the economic and financial backgrounds required to derive maximum benefit from the software package. USAID and Treasury officials in Washington were not aware that the institute was not using the computer software.

Officials of the institute in Hungary cited their lack of involvement in training provided at the institute by KPMG Peat Marwick as an example of a lost opportunity to develop the institute's capabilities. The training was provided to approximately 300 bankers from the former Soviet Union in the spring of 1993 using institute facilities. According to the Director, the institute's faculty and staff did not participate in developing the training curriculum or in teaching classes. The Director was critical of the training, maintaining that it was oriented to the American free market system and too advanced for the bankers from the former Soviet Union. The Director said that her faculty and staff are familiar with the problems involved in making the transition from a centrally-planned economy to a market economy and could have helped bridge the gap between the American and Soviet economic systems. However, KPMG Peat Marwick did not consult with the Director or her staff.

Treasury officials stated that their objective in providing the training was to instruct the bankers from the former Soviet Union in banking and financial management. According to the officials, they did not intend to develop a model for making the transition from a centrally-planned economy to a market economy. The officials acknowledged, however, that the institute's faculty and staff could have benefited from participating in designing and delivering the training.

Efforts are needed to ensure the sustainability of Poland's Warsaw School of Banking. Assistance being provided by KPMG Peat Marwick to the banker training institute in Poland, the Warsaw School of Banking, was developing the training capacity of the institute. For example, the long-term adviser provided by KPMG Peat Marwick had surveyed local bankers to determine their training needs and developed the institute's curriculum to meet those needs. Further, unlike Hungary's International Training Center for Bankers, Ltd., the Warsaw School of Banking was using the computer software supplied by KPMG Peat Marwick to train upper-level bank managers. However, we found that little action has been taken to ensure the sustainability of the institute in Poland after U.S. assistance ends, a situation likely to occur when Treasury's contract with KPMG Peat Marwick expires on September 30, 1994.

Although the Warsaw School of Banking is receiving support from other donors, the bulk of the institute's training and instruction costs are supported by the Department of the Treasury, through its contract with KPMG Peat Marwick. Most classes are taught by short-term instructors brought in from the U.S. specifically to teach the classes or by the long-term adviser provided by KPMG Peat Marwick, who at the time of our audit was planning to return to the U.S. in May 1994. According to the Finance Director, the institute lacks the financial resources needed to replace the assistance being provided by KPMG Peat Marwick and alternative funding resources have not been identified. The Finance Director is relying on continued funding for the institute by Treasury.

The Warsaw School of Banking may not be financially viable after U.S. assistance ends because Treasury has not ensured that KPMG Peat Marwick develops plans for the institute's sustainability. Such plans should include methods for identifying alternative funding sources to supplant the U.S. Government assistance and procedures for identifying and training local Polish instructors.

In summary, plans for the financial viability of the Warsaw School of Banking are needed to ensure that the institute continues after U.S. Government assistance ends. Without plans for obtaining alternative funding sources and recruiting and training local instructors for the institute, Treasury's overall objective of developing a viable training facility for Polish bankers may not be achieved.

Under its contract with Treasury, KPMG Peat Marwick provided a long-term technical adviser and training materials to the Warsaw School of Banking in Poland. The adviser is pictured above instructing students. (November 1993)

Management Comments and Our Evaluation

Responding to the draft audit report, the Department of the Treasury stated that our observations and recommendations were useful contributions to the management of its technical assistance program. In response to our recommendation concerning the banker training institute in Hungary, Treasury stated that in 1992 when it contracted with KPMG Peat Marwick to provide technical assistance to banker training institutes in Central and Eastern Europe, the institute in Hungary had a relatively well developed program, in contrast to other institutes in the region. As a consequence, Treasury stated that it decided to provided limited assistance to the institute in Hungary and focus it resources on the less developed institutes. According to Treasury, the institute in Hungary requested that Treasury provide the "Bankexec" software package and instruction in its use.

In reviewing the Hungarian banking institute's use of the "Bankexec" software, Treasury stated that two problems were evident. First, Treasury believed that additional effort was needed to effectively convey training techniques to the institute's instructors. Treasury had, therefore, arranged with KPMG Peat Marwick to conduct an additional workshop in September 1994 to train 20 additional instructors. Nevertheless, Treasury was not confident that the institute would find the accumulated training adequate to provide the course independently on a regular basis. According to Treasury, however, a more intensive effort in the waning months of the KPMG Peat Marwick contract was not likely to ameliorate the situation.

Second, Treasury believed that the full value of the "Bankexec" training software can only be gained if trainees are seeking to learn how different departments of a commercial bank interrelate and support each other. According to Treasury, however, it appears that the Hungarian banking community's human resource development needs may not have been defined well enough to encourage trainees to regard the "Bankexec" experience as a contribution to their professional development.

Treasury cited the following lessons learned from its assistance efforts to Hungary's International Training Center for Bankers, Ltd. First, Treasury stated that it assumed the institute knew its future curriculum requirements—an assumption which proved to be unfounded. Treasury stated that it erred in agreeing to provide "Bankexec" rather than a set of courses suited to the needs of the banking system in Hungary. Second, Treasury believed that its limited assistance effort to the institute in Hungary should have been supported by the same level of planning and analysis committed to larger assistance efforts to other banker training institutes in Central and Eastern Europe. In concluding, Treasury questioned its decision to provide any assistance to the banker training institute in Hungary suggesting that greater regional benefit may have been achieved had the assistance been provided to other institutes in the region.

With reference to our finding on the sustainability of the banker training institute in Poland, the Warsaw School of Banking, Treasury stated that our concern is well placed. According to Treasury, institute management has prepared a business plan adequately addressing the institute's long-term operational and financial viability. However, little consideration has been given to sustainability in the short-term. Treasury is particularly concerned about the period immediately following expiration of the technical assistance contract with KPMG Peat Marwick in September 1994. To achieve short-term sustainability, Treasury has suggested that USAID continue assistance to the Warsaw School of Banking after the contract with KPMG Peat Marwick expires. Treasury also suggested that institute management reassess the fees charged for courses—amounts currently at minimal levels, according to Treasury.

In its response, the Bureau for Europe and the New Independent States (ENI Bureau) stated that continued assistance to Hungary's International Training Center for Bankers, Ltd. will be restricted to delivering specific courses. The ENI Bureau also stated that Treasury assistance to banker training institutes is phasing down and will end in September 1994. Further, institutional development of the institute in Hungary would involve a longer time commitment than the ENI Bureau indicated it and Treasury are willing to make. The ENI Bureau noted that Treasury's plans to assist the institute with "Bankexec" will result in more efficient use of the $15,000 software package.

With reference to our finding concerning the Warsaw School of Banking, the ENI Bureau stated that it will work with Treasury and the institute to develop a strategy identifying alternative funding sources and specifying procedures for recruiting and training instructors. In addition, the ENI Bureau stated that it will begin providing direct funding for the Warsaw School of Banking when the KPMG Peat Marwick contract expires.

All three parts of Recommendation No. 1 are resolved and can be closed when planned actions by Treasury and the ENI Bureau are completed.

Indicators for Measuring Progress Are Needed

Sound management practices require that specific goals and progress indicators be established to ensure that technical assistance activities are properly focused and that information is available with which to measure progress and results. The Department of the Treasury had not established progress indicators for technical assistance activities in Hungary and Poland because early on a low priority was assigned to establishing such indicators. Without progress indicators, however, it is difficult to measure the impact of Treasury's technical assistance activities and for the USAID Representatives to carry out monitoring responsibilities. Treasury has acknowledged the need for progress indicators. The most recent interagency agreement, signed in July 1993, transferring funds from USAID to Treasury requires that progress indicators be established for activities funded under the agreement. In addition, Treasury plans to require progress indicators for each of its resident advisers.

> <u>Recommendation No. 2:</u> **We recommend that the Bureau for Europe and the New Independent States, in consultation with the USAID Representatives in Hungary and Poland, ensure that the Department of the Treasury's Fiscal Year 1995 workplans for Hungary and Poland, required under the interagency agreement dated July 22, 1993, provide for the development of progress indicators for technical assistance activities conducted by each long-term adviser so that progress and results in achieving specific objectives established for the technical assistance activities can be measured.**

Sound management practices dictate that specific goals be established for technical assistance activities and that progress indicators be established so that progress in achieving program goals can be measured and results and impact can be determined. Discussions with Treasury and USAID officials, including advisers in the field and their counterparts, and reviews of available documentation revealed that Treasury had not established indicators against which progress in achieving program goals could be measured.

We reviewed progress reports prepared by Treasury's long-term advisers in Hungary and Poland for the quarter that ended September 30, 1993. Most reports describe the advisers' activities during the period, any obstacles they encountered, and advisers' coordination efforts with other donors. Our review revealed that none of the reports prepared by the ten advisers in Hungary and Poland compared activities during the quarter to progress indicators. The reports identified goals, but did not specify benchmarks or targets against which to measure progress. For example:

- The progress report for the adviser to the Hungarian government organization formulating privatization policy for commercial banks specified the adviser's goal as providing technical assistance that will advance the banking and financial sector reform process and accelerate the privatization of state-owned commercial banks.

The progress report listed the adviser's achievements during the quarter as: working with prospective investors to state-owned commercial banks; assisting in an assessment of state-owned companies to determine their assets and liabilities; and helping USAID prepare a proposal for a USAID-funded project. However, the report did not identify benchmarks or targets to be achieved during the period against which performance could be measured. As a result, it is difficult to assess progress in achieving the overall goal.

- An adviser to Poland's Ministry of Finance listed his goal as to provide policy, managerial, and technical advice to the Ministry and Poland's chief debt negotiator in preparing for discussions with Western lenders concerning renegotiation of Poland's foreign debt.

  Achievements reported by the adviser for the quarter included: serving as intermediary with commercial and investment banks concerning business opportunities related to commercial debt; providing technical advice in preparing a comprehensive debt and debt service reduction agreement; and preparing reports and briefings for negotiating sessions with Poland's external creditors. However, no benchmarks or targets were specified. Therefore, it is difficult to measure the adviser's progress.

Our prior audit[4] of Treasury's technical assistance activities in Bulgaria identified the same problem—progress indicators had not been established. The audit report recommended that such indicators be implemented. The report also pointed out that the development and use of progress indicators would help Treasury eliminate vulnerabilities identified by the Treasury Office of the Inspector General.

Progress indicators were not established for Treasury activities in Hungary and Poland because developing such indicators was a low priority early in Treasury's technical assistance program. According to Treasury, in the early days of assistance to countries of Central and Eastern Europe, the President and the Congress placed priority on delivering assistance to solidify the changes that were occurring in the

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[4] *See pages 13 through 17 of "Audit of the Department of the Treasury's Technical Assistance Activities in Bulgaria" (A/R No. 8-183-94-003, dated February 25, 1994).*

region. Thus, Treasury's early emphasis was on providing assistance as quickly as possible with little concern for measuring progress.

Treasury has since realized the need for progress indicators as evidenced in its most recent interagency agreement with USAID, signed July 22, 1993. The interagency agreement requires annual workplans for each country where Treasury technical assistance is provided. The workplans should include indicators for each activity to measure progress toward achieving activity goals.

Management Comments and Our Evaluation

In its response to the draft report, the Department of the Treasury stated that the report appropriately placed strong emphasis on the development of progress indicators as a tool in managing assistance programs. Treasury agreed that it needs a more systematic effort to assess the contribution toward reform which emanates from Treasury-managed technical assistance. Treasury stated that it is determined to develop a clear and useful system of progress indicators in close consultation with USAID management. Further, Treasury noted that the need for such indicators has also been cited by the Department of the Treasury's Office of the Inspector General.

Treasury indicated that each resident adviser, the basic unit of the Treasury-managed program, will be asked to prepare specific goals and milestones within several weeks of arrival at post. These goals and milestones will be reviewed and accepted or modified by Treasury, in cooperation with USAID. Progress toward achieving these goals will be periodically evaluated.

In its response to the draft report, the Bureau for Europe and the New Independent States (ENI Bureau) stated that Treasury is developing general workplans for each country in Central and Eastern Europe to be submitted to the respective USAID Representative for review and concurrence. In addition, Treasury plans to develop workplans containing results-oriented indicators for each resident adviser within several weeks after arrival at post. Advisers will describe progress toward achieving the indicators in their quarterly progress reports. ENI Bureau officials believed that this reporting will greatly enhance the ability of USAID Representatives to monitor the advisers' progress.

Based on the ongoing and planned action by the Department of the Treasury and the ENI Bureau, Recommendation No. 2 is resolved. The Recommendation can be closed once evidence is provided that progress indicators are being developed for the technical assistance conducted by Treasury's long-term advisers, indicators which are acceptable to the ENI Bureau and provide a basis for measuring progress and results.

Did USAID Representatives in Hungary and Poland carry out oversight responsibilities for the Department of the Treasury interagency agreements in accordance with applicable legislation and internal requirements?

The USAID Representative in Hungary was monitoring and overseeing Treasury technical assistance activities in accordance with applicable legislation and internal requirements; however, the USAID Representative in Poland was not fully carrying out oversight responsibilities.

The Fiscal Year 1993 Foreign Operations Appropriations Act and Regional Mission for Europe Mission Order No. 103 state that the USAID Representative is responsible for in-country oversight and monitoring of activities financed by and through USAID. The USAID Representative in Hungary was carrying out these responsibilities for Treasury technical assistance activities. Our discussions with the USAID Representative disclosed that his office initially lacked the staff needed to conduct the monitoring and oversight. As a result, the U.S. Embassy's economic section performed these functions. However, the USAID Representative had recently hired a project specialist under a personal services contract. The project specialist monitors and oversees the Treasury technical assistance through frequent contacts with Treasury advisers, participation in monthly adviser group meetings, and reviews of the advisers' quarterly progress reports. The project specialist also monitors and oversees assistance to the International Training Center for Bankers, Ltd. provided by KPMG Peat Marwick under a contract with Treasury. Another USAID Representative employee monitors and oversees Treasury's technical assistance in the area of tax policy.

The USAID Representative in Poland was not fully carrying out monitoring and oversight responsibilities for Treasury's technical assistance activities in Poland in accordance with applicable legislation and internal requirements, but has taken steps to improve monitoring and oversight. In addition, the USAID Washington project officer for Treasury interagency agreements needed to do more to facilitate the monitoring and oversight roles of the USAID Representatives in Hungary and Poland. These issues are discussed more fully below.

The USAID Representative in Poland Was Taking Steps to Increase Monitoring/Oversight of Treasury Technical Assistance Activities

The Fiscal Year 1993 Foreign Operations Appropriations Act and Regional Mission for Europe Mission Order No. 103 state that the USAID Representative is responsible for in-country oversight and monitoring of activities financed by and through USAID. We found, however, that the USAID Representative in Poland was exercising limited oversight of the Treasury program. Oversight by the USAID Representative in Poland was limited because: (1) Treasury advisers did not clearly understand the oversight role and responsibilities of the USAID Representative; (2) the USAID Representative lacked sufficient staff to adequately monitor the Treasury activities in Poland; and, (3) some advisers signed confidentiality statements with the Polish Ministry of Finance limiting contacts outside the Ministry. However, steps taken by the USAID Representative in Poland to mitigate these situations will improve oversight of the Treasury activities. Therefore, we are not making recommendations concerning the USAID Representative in Poland's oversight role.

The Fiscal Year 1993 Foreign Operations Appropriations Act states that the USAID Representative is responsible for coordinating implementation of U.S. Government activities in Central and Eastern Europe and the Baltic States. In reaction to this legislation, the Regional Mission for Europe issued Mission Order 103, dated December 1, 1992, containing guidance to USAID Representatives on how to comply with this and other requirements contained in the Appropriations Act. With respect to activities carried out by other U.S. Government agencies, the Mission Order states that USAID Representatives will continue to be responsible for in-country oversight and monitoring of all activities financed by or through USAID in their respective countries.

Discussions with officials at the Office of the USAID Representative in Poland disclosed that the USAID Representative was not fully carrying out oversight responsibilities for Treasury activities there. The officials said that in the past oversight of Treasury activities was carried out primarily by the economic section of the U.S. Embassy. The Office of the USAID Representative is planning to take over this function. However, according to the USAID officials, the staff of the U.S. Embassy and the Treasury advisers assigned to Poland have not understood the USAID Representative's oversight role. Also, the USAID Representative's small staff prevents the office from assuming full oversight responsibilities for Treasury activities. In addition, according to Treasury officials, two of the advisers in Poland have signed confidentiality statements with the Polish Ministry of Finance which restrict contacts outside the Ministry, including contacts with the USAID Representative.

Our audit also found that the USAID Representative in Poland has taken steps to improve oversight of Treasury activities. In August 1993, the USAID Representative issued a memorandum to the U.S. Embassy staff and to in-country staff of agencies implementing USAID-funded activities in Poland—including the Treasury advisers, according to the USAID Representative. The memorandum outlined the USAID Representative's monitoring and oversight responsibility for USAID-funded activities, including those implemented by other U.S. Government agencies, such as Treasury, under interagency agreements. In addition, the USAID Representative has taken steps to hire an employee under a personal services contract whose primary responsibility will be to monitor and oversee Treasury activities. These steps should greatly improve the USAID Representative in Poland's monitoring and oversight capabilities. Because of these steps, we are not making recommendations concerning the USAID Representative's oversight role.

Documents Needed to Monitor
<u>Treasury Activities Were Not Available</u>

According to implementing guidance, Washington project officers are responsible for providing project-related guidance and information to the USAID Representatives to facilitate their role in monitoring and overseeing in-country project activities. Our audit found that key documents needed to carry out monitoring and oversight responsibility for Treasury technical assistance activities in Hungary and Poland were not available at the Offices of the USAID Representatives in Hungary and Poland. The documents were not available because support to the USAID Representatives by USAID's Washington project officer for Treasury interagency agreements has been limited. As a result, the capabilities of the USAID Representatives in Hungary and Poland to monitor and oversee Treasury's technical assistance activities in their respective countries have been impaired.

> <u>Recommendation No. 3:</u> **We recommend that the Bureau for Europe and the New Independent States ensure that USAID's Washington project officer for interagency agreements with the Department of the Treasury provides key documents (such as interagency agreements, contractors' scopes of work, and the Department of the Treasury's quarterly country progress reports) to USAID Representatives in Hungary and Poland needed to monitor and oversee the Department of the Treasury's technical assistance activities in these countries.**

Regional Mission for Europe Mission Order 104 assigns responsibility to the Washington project officer for providing project-related guidance and information to the USAID Representatives to facilitate their role in monitoring and overseeing in-country project activities.

Our audit found that key documents needed to monitor and oversee Treasury technical assistance activities in Hungary and Poland were not available at the offices of the USAID Representatives. We reviewed the files at the USAID Representative offices in Hungary and Poland to determine whether the files contained key documents. Although files at the office in Hungary were more complete than those at the office in Poland, we found that the following key documents were not available at either USAID Representative office:

- all interagency agreements that have been signed between USAID and the Department of the Treasury;

- contract scopes of work for Treasury's technical assistance advisers working in-county; and

- the Department of the Treasury's quarterly country reports concerning technical assistance.

In addition, the files at the USAID Representative in Poland did not contain copies of the quarterly progress reports prepared by Treasury's in-country technical assistance advisers.

Key documents were not available at the Offices of the USAID Representatives because, according to office officials, support to the field by USAID's Washington project officer for Treasury interagency agreements has been limited. The USAID Representative in Hungary said that his office has repeatedly requested the Washington project officer to provide the key documents. However, these requests have not been answered. Officials at the Office of the USAID Representative in Poland related similar problems. According to the officials, the Washington project officer has not provided basic documents, such as interagency agreements between USAID and Treasury and quarterly progress reports prepared by Treasury advisers.

Key documents are essential to the USAID Representatives in carrying out monitoring and oversight responsibilities for Treasury technical assistance activities. Documents such as the interagency agreements, Treasury advisers' quarterly progress reports, and advisers' scopes of work are needed to monitor and measure progress in achieving the goals and objectives of Treasury's technical assistance. Without the key documents, USAID Representatives in Hungary and Poland can not effectively carry out monitoring and oversight responsibilities.

The lack of key documents needed by USAID Representatives to monitor activities implemented by other U.S. Government agencies has been a long standing problem in USAID's Central and Eastern Europe program. We first reported on this problem in our June 30, 1992 audit report "Audit of the A.I.D. Organizational Structure for Central and Eastern Europe" (A/R No. 8-180-92-01). In that report, we pointed out that USAID Representatives did not have all the means needed to monitor effectively, noting, for example, that USAID Representatives do not routinely receive (1) project documentation such as copies of contracts, grants, cooperative agreements, etc., and (2) the progress reports of contractors, grantees, and other U.S. Government agencies. Audits we have performed of other U.S. Government agencies' activities in Central and Eastern Europe countries, including this current audit, have demonstrated that the lack of documentation continues to be a problem.

Management Comments and Our Evaluation

In response to the draft report, the Bureau for Europe and the New Independent States (ENI Bureau) described steps taken to improve communication between Treasury and USAID Representatives. First, the ENI Bureau is encouraging, at a minimum, biweekly conversations between the USAID Representative and the Treasury desk officer assigned to each country. In addition, Treasury routinely sends advisers' quarterly progress reports to the USAID Representatives. Second, Treasury has requested its advisers to provide copies of their quarterly progress reports to the in-country USAID Representative at the same time the reports are submitted to Treasury.

The ENI Bureau also stated that the USAID Representatives in Hungary and Poland have each been provided a complete set of key documents. However, subsequent contact with the Office of the USAID Representative in Hungary indicates that several documents requested from Washington had not been provided.

Although efforts have been made to improve communications between Treasury and the USAID Representatives, the long-standing documentation problem discussed in this report continues to exist. The problem is not limited to Hungary and Poland, but affects USAID Representatives in the seven Central and Eastern Europe countries and the three Baltic States. Therefore, Recommendation No. 3 is unresolved until procedures have been established to ensure that USAID Representatives receive the documents needed to carry out monitoring responsibilities. The Recommendation can be closed when evidence is provided that the procedures have been implemented and key documents have been supplied to the USAID Representatives in all seven Central and Eastern Europe countries and the three Baltic States.

SCOPE AND METHODOLOGY

We audited the Department of the Treasury's technical assistance activities in Hungary and Poland funded through interagency agreements with the Bureau for Europe and the New Independent States. The audit was conducted in accordance with generally accepted government auditing standards. We performed the audit from November 9, 1993 to February 10, 1994. The audit covered activities implemented in Hungary and Poland by the Department of the Treasury with funds transferred from the U.S. Agency for International Development (USAID) under three projects: Project No. 180-0026 (Competition Policy, Laws and Regulations); Project No. 180-0027 (Business Services); and Project No. 180-0035 (Bank Training).

As of December 31, 1993, we estimate that obligations in Hungary and Poland under the three projects were approximately $9 million—$2.4 million for Hungary and $6.6 million for Poland. As of the same date, we estimate that expenditures in the two countries totaled about $4.4 million—$1.6 million for Hungary and $2.8 million for Poland. We conducted audit work in Washington at the offices of the Department of the Treasury and USAID's Bureau for Europe and the New Independent States. Field work in Hungary and Poland included visits to USAID Representative offices, the Ministries of Finance in both countries, offices of Treasury long-term advisers and host-country counterparts, and other donor organizations. We also visited the International Training Center for Bankers, Ltd. in Hungary and the Warsaw School of Banking in Poland.

We reviewed Treasury and USAID project documentation to: (1) determine the specific technical assistance objectives for activities being conducted in Hungary and Poland; (2) identify the amount of USAID funds budgeted for and expended by Treasury; and, (3) determine if progress indicators had been established. We interviewed USAID, American Embassy, Treasury and other donor officials in the U.S., Hungary, and Poland to obtain their views on the effectiveness and usefulness of Treasury's technical assistance activities. Additionally, we:

- reviewed August 1993 evaluations of USAID's financial sector reform programs in Hungary and Poland;

- interviewed Treasury long-term advisers in Hungary and Poland to discuss their assistance activities, accomplishments and problems, and views on the effectiveness of Treasury's monitoring of their activities;

- interviewed Hungarian and Polish counterparts for Treasury's long-term advisers to determine how the assistance was being received and whether the assistance was meeting the counterparts' needs;

- interviewed KPMG Peat Marwick's long-term adviser in Poland to discuss the assistance to the Warsaw School of Banking being provided by KPMG Peat Marwick under a contract with Treasury; and,

- interviewed USAID Representative officials in Hungary and Poland to determine how the offices were carrying out oversight responsibilities for Treasury's technical assistance activities.

For the first audit objective, we asserted criteria for the finding concerning the lack of progress indicators for Treasury technical assistance activities in Hungary and Poland. The interagency agreements in effect at the time of our audit did not require that Treasury establish specific objectives and progress indicators for its technical assistance activities. We believe that certain program design elements, including specific objectives and progress indicators, are critical to the success of any assistance program and without them it is difficult to measure the results of the assistance. The Bureau for Europe and the New Independent States' most recent interagency agreement with Treasury, signed July 22, 1993, requires Treasury to develop country-specific workplans containing, among other things, benchmark indicators of progress towards achieving the program goals and objectives.

The objectives of this audit did not allow for sufficient testing to comment on the overall adequacy of internal controls of either the Bureau for Europe and the New Independent States or the Offices of the USAID Representatives in Hungary and Poland. Therefore, we did not prepare a separate report on internal controls. However, we did assess the Offices of the USAID Representatives' internal controls for monitoring the Department of the Treasury's activities in Hungary and Poland.

Further, our audit work in testing for compliance dealt only with whether the Offices of the USAID Representatives in Hungary and Poland were carrying out oversight responsibilities for Treasury interagency agreements in accordance with requirements of the Fiscal Year 1993 Foreign Operations Appropriations Act and Regional Mission for Europe Mission Order No. 103, dated December 1, 1992.

USAID

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

MAY 6 1994

MEMORANDUM

TO: RIG/A/EUR/W, James Bonnell

FROM: DAA/ENI, Barbara Turner

SUBJECT: Draft Comments of the RIG Audit of the Department of the Treasury's Technical Assistance Activities in Hungary and Poland

After reviewing the Regional Inspector General's Draft Audit Report pertaining to Hungary and Poland, dated April 8,1994, my staff and I have additional comments pertaining to the recommendations stated therein.

Recommendation No.1 discusses assistance to the Hungarian International Center for Bankers and the Warsaw School of Banking.

1.1 Continued assistance to Hungary's International Center for Bankers will focus on specific course delivery which is what has been requested by the international training center. This project is in a phase out situation (ending September 1994) and the institutional development would involve a longer time commitment than Treasury is willing to make for this project. A.I.D. concurs with this decision.

1.2 We concur in the amount of $15,000 as the value of computer software. KPMG is currently working with the International Training Center to develop a plan for usage of the software. Thus, this recommendation may be either dropped or can be promptly closed.

1.3 In the remaining six months of this contract Treasury will be working with the Warsaw School of Banking to develop a strategy which both identifies alternative funding sources and specifies procedures for recruiting and training instructors. Because this is an institution AID will begin to fund directly after the Treasury contract expires, an AID project officer will be working in collaboration with Treasury and the Warsaw School of Banking in this area. Development of a funding strategy is considered a top priority in assistance to this entity. This recommendation, therefore may be either dropped or can be promptly closed.

Recommendation No.2 discusses the requirement that workplans required under the Interagency Agreement, dated July 22,1993 be provided. Subsequent to the beginning of this audit these workplans, not only for Hungary and Poland, but for the entire region were developed by Treasury. Consequently, this recommendation may be either dropped or can be promptly closed.

However, the development of workplans is an ongoing process and considerable refinement has taken place in recent months which will be reflected in language of the FY1994 IAA currently being negotiated. General workplans will be developed by Treasury for each country which will be submitted to the AID Representative for review and concurrence. Additionally, workplans will be developed by Treasury for each advisor within six weeks of assumption of post and provided to the AID Representative office within two months for their feedback. These advisor-specific workplans will contain results-oriented indicators which will be reported in the Quarterly Reports required of each advisor. This should give the AID Representative offices a tangible document and greatly enhance their ability to monitor actively the progress of the Treasury advisors.

Recommendation No.3 discusses the role of the AID project officer in providing key documents. Subsequent to the first intelligence from the IG documents a complete set of documents has been provided to Hungary and Poland and again, this recommendation may be either dropped or can be promptly closed. We do take exception to the discussion on page 21 as noted below.

In the case of Poland although no request was made of the Washington project officer for specific documents, she can be faulted for not taking the initiative. According to Mr. Watts of your office, there were a significant number of documents missing.

For Hungary, however, according to Mr. Watts, the situation is different -- the files are virtually complete. The AID Project Officer has been receptive to communication from the AID Representative and emails have been answered promptly. (Documentation can be provided if required.)

Going forward, a series of steps are being taken in order to facilitate communication between the Treasury and the AID Representative Offices, on not only the receipt of documents, but on a whole range of issues. AID is encouraging direct contact and regular biweekly conversations between the AID Representative office and the Treasury desk officer assigned to the country.

The quarterly reports are routinely sent by Treasury to the AID representative offices. In addition, Treasury is asking their in-country advisors to provide a draft copy of this report at the same time it goes to Treasury.

As noted above, the IAA currently being negotiated will require advisors to use the quarterly report to describe progress made on benchmarks. There will also be requirements to share with AID Representatives written communication between Treasury and counterpart governments and to provide terms of reference within a specified timeframe.

LL:4/94AUDITHP

USAID
U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MAY 6 1994

TO: RIG/A/Bonn, John P. Competello

SUBJECT: Audit Representation Letter - Audit of the Department of the Treasury's Technical Assistance Activities in Hungary and Poland

During the period November 9, 1993, through February 10, 1994, RIG/A/Bonn conducted the subject audit for the purpose of answering the following audit objectives:

- What were USAID funds used for and what results were being achieved in relation to the project purposes as stated in the Regional Mission for Europe's interagency agreements with the Department of the Treasury in Hungary and Poland?

- Did the USAID Representative for Hungary and Poland carry out oversight responsibilities for the Department of the Treasury interagency agreement in accordance with applicable legislative and internal requirements?

In the case of Section 632 transfers and allocations, as in this case, whereby USAID funds are used by another U.S. agency under the terms and conditions of an Interagency Agreement, the two agencies discharge various oversight and coordinating responsibilities under pertinent provisions of the Appropriations Act of 1993, RME Mission Orders, the terms and conditions of the Interagency Agreement itself, and individual Interagency Agreement implementing arrangements. To the extent of USAID responsibilities thereunder as of May 5, 1994:

1. I have asked the most knowledgeable, responsible members of my staff to make available to you all records in our possession for the purposes of this audit. Based on the representations made by these individuals, of which I am aware, and my own personal knowledge, I believe that those records constitute a fair representation as to the matters under audit, at least insofar as records in USAID's possession. Please note that faxes, notes, and other informal communications, which are not part of the official files, are not systematically kept by our office. Please note also that records in Treasury's possession are also part of the record in this matter.

2. To the best of my knowledge and belief, RME has disclosed any known:

   -- irregularity involving management or employees who have roles in the internal control structure,

   -- irregularity involving any other organizations that could affect the subject audit, and

   -- communication from any other organizations that could affect the subject audit.

3. To the best of my knowledge and belief, RME is not aware of any material instance where significant management information has not been properly or accurately recorded and reported to responsible management, at least insofar as USAID staff is concerned.

4. To the best of my knowledge and belief as a layman, and not as a lawyer, RME has not withheld any information, of which it is aware, about instances of material non-compliance with USAID policies and procedures (as modified by RME policies and procedures) or possible violations of U.S. law or regulations.

5. To the best of my knowledge and belief as a layman, and not as a lawyer, RME has not withheld information, of which it is aware, about material non-compliance with the interagency agreements with the Department of Treasury that could materially affect those agreements.

6. Following our review of your Draft Report and further consultation with my staff, I know of no other facts as of the date of this letter which, to the best of my knowledge and belief, would materially alter the conclusions reached in that document.

I request that this representation letter be included as a part of the official management comments on the draft report and that it be published herewith as an annex to the report.

Barbara Turner

Barbara Turner
Deputy Assistant Administrator
Bureau for Europe and the New
Independent States

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 11, 1994

Mr. John P. Competello
Regional Inspector General for Audit/Bonn
Office of the Regional Inspector General
U.S. Agency for International Development
American Embassy
Deichmanns Aue 29
53170 Bonn, Germany

Dear Mr. Competello:

Thank you for your letter of April 8, 1994 to Deputy Assistant Secretary Lipton, which solicited our comments concerning your draft audit report on AID oversight of Department of the Treasury technical assistance activities in Poland and Hungary.

Your observations and recommendations are useful contributions to the management of the Treasury technical assistance program. I believe we will be able to respond positively to most of the recommendations which would require Treasury action.

It appears useful to discuss three subjects raised in the report: (1) efforts to increase the effectiveness of assistance to the International Training Center for Bankers in Budapest, (2) required steps to assure the future sustainability of the Warsaw Institute of Banking, and (3) the development of program impact indicators.

Raising Productivity of the International Training Center for Bankers in Budapest

The International Training Center for Bankers was established in 1988 in Budapest with assistance from the Government of France (provided by the Centre de Formation de la Profession Bancaire, the French banking industry's training arm) and the World Bank, which supported a feasibility study.

The Center had a relatively well-developed program in 1992 when the Treasury Department awarded a contract for banker training services to KPMG Peat Marwick. In contrast, other banker training institutions in the region were in their infancies. As a consequence, Treasury decided to provide only limited assistance to the Center in Budapest in the hopes of broadening its curriculum, while concentrating project resources in the nascent training institutions in other countries.

The Center requested that Treasury provide BankExec (enclosure), a computer simulation bank management game produced by the American Bankers Association and designed to convey to aspiring professionals the interrelationship among bank departments in the conduct of the banking business. Since this type of course was a distinct departure from other Center course offerings, the Center request fit well with Treasury Department thinking.

The course software was delivered in September 1992, together with a workshop to train the future Hungarian instructors. Your draft report states that the Center is not using the BankExec training software that Treasury has provided.

Having examined the situation, two problems are evident. First, additional effort is needed to convey training techniques effectively to instructors. During the initial workshop in October, 1992, eight persons were trained to teach the BankExec course at the Center. In a second seminar in May, 1993, an additional eighteen persons were trained. Treasury has arranged for KPMG Peat Marwick to provide an additional workshop to train trainers in September, 1994, with an estimated twenty trainees.

Treasury is not confidant that the Center will find the accumulated training adequate to provide the course independently on a regular basis. However, a more intensive effort in the waning months of the KPMG contract seems unlikely to ameliorate the situation. The number of trainees who will have taken the course does not appear to be a decisive factor. The selection procedures and professional backgrounds may be more important, but are less amenable to modification in the next five months.

Second, the full value of the BankExec training software can only be gained if trainees are seeking to learn how different departments of a commercial bank interrelate and support each other. To meet this training goal, commercial banks need to have and convey a clear expectation that their professional employees will take the course, acquire the skills and employ the skills on the job. It appears that the banking community's human resource development needs may not have been defined well enough to encourage trainees to regard the BankExec experience as a contribution to their professional development.

The KPMG Peat Marwick contract to provide banker training services expires on September 30, 1994. In the remaining months, it is not clear that the utility of BankExec to the Center can be significantly increased in the Center, although KPMG Peat Marwick is offering some additional assistance.

The lessons we draw from this situation are that: (a) our assumption that the Center had a relatively well-developed understanding of its future curriculum requirements was not warranted, and (b) that the Treasury intention to sustain only a relatively low level of program activity in Hungary, compared to other countries, probably still required as much planning and analysis as the larger efforts in the other countries in Central and Eastern Europe.

The Treasury Department probably erred in agreeing to provide BankExec, rather than providing a set of professional courses better suited to the perceived human resource needs of the reforming banking systems, as was done in other countries in the region. On the other hand, in terms of the regional goals of the banker training project, it might have been better to omit banker training activities in Hungary entirely, rather than dilute the efforts in the other five countries in order to mount a more substantial Hungarian program.

Assistance to the Warsaw Institute of Banking

The concern regarding the sustainability of the Warsaw Institute program is well placed. The Warsaw Institute began full-time training operations in the Fall of 1993 after two years of discussion in the Polish banking community. With less than one year of operating experience, the Institute has made initial progress toward the professional and financial goals which will lead to sustainability.

In 1993, the Institute prepared a business plan with the assistance of IDOM, a British consulting firm. The plan addressed both the operational and financial issues of running the Institute. Currently, the Institute charges only minimal fees for its courses, which is the result of policies adopted by the shareholding commercial banks. The shareholders view the key to sustainability to be the training of Polish trainers to replace expatriate instructors. Polish trainers will reduce the cost of the training program to levels which the shareholders feel able to support. While Treasury believes that the strategy may bear fruit in the longer term, sustainability is not likely to occur immediately after the KPMG Peat Marwick contract expires in September.

Treasury has suggested that AID consider continuing assistance to the Warsaw Institute after the expiration of the Treasury contract with KPMG Peat Marwick. Such continued assistance may overcome the late start of the Warsaw Institute. We understand that AID is giving the suggestion earnest consideration. We also believe that the Institute should revisit the fees for its courses and have conveyed that view to Institute management.

In the longer term, Treasury feels confidant that the Warsaw Institute will make a solid contribution to the human resources needs of the Polish banking system. We have been impressed by the vigorous support for the Institute which has been offered by Polish commercial banks. We are also impressed that the Institute management is fully cognizant of the steps required to achieve sustainability. As Mr. Andrzej Lech, President of the Institute stated in a September 24, 1993 letter to the Treasury Department:

> The focus of the coming months, however, will be put on the development of the comprehensive target programme structure and the train the trainers module. Success in these two areas will guarantee the achievement of one of our ultimate goals, i.e., financial and teaching personnel independence in [the] foreseeable future.

In the end, a practical professional training program is the only sound basis for sustainability. We believe that Institute management understands this point well.

Program Impact Indicators

Your draft report places appropriately strong emphasis on the development of program impact indicators as tools to manage assistance programs.

In the first years of the U.S. technical assistance program in Central and Eastern Europe and the former Soviet Union, the Treasury Department placed a high priority on putting in place assistance efforts in order to advance and solidify the changes that were occurring in these countries.

The priority which the President and the Congress placed on delivering assistance quickly was given greater emphasis by program managers than developing systems to assess progress to reform goals. Complete failure would have been painfully obvious: governments could have reversed the democratic and market-oriented reforms and could have returned to a reconstituted Soviet bloc. Or, more particular to the Treasury program, advisers would have been rejected or ignored by the authorities rather than win the requests for their continuation which have generally occured. Neither failure happened.

Now, with several years of effort, we agree that it is time to take a hard look at the impact that the technical assistance program is having in order to move resources from marginal or completed activities to those more in keeping with current stages of reform.

In counseling us in a March 13, 1993 memorandum, the Treasury Department Inspector General (TIG) offered several principles and good practices that should be incorporated in this type of program, including program impact indicators. We expect that the TIG will look for these management principles and practices as part of its planned FY 1995 audit of the technical assistance program.

Early in the current Administration, we concluded that assistance to improve the operations of individual state-owned banks, while useful, was having only a marginal impact on reforming the economic and financial systems in these countries. As a result, we initiated a phased reallocation of resources away from commercial banking and toward extending assistance to policy forming components of finance ministries where successful reform can have a broad impact on economic and financial systems.

Similarly, the progress toward reform in some countries, such as the Czech Republic and Estonia, and weak momentum toward reform in other countries, such as Belarus, suggested the need to reallocate technical assistance resources to areas where they would be most useful. This process is well underway.

However, as your draft report suggests, we need a more systematic effort to assess progress toward reform and the contribution to reform which emanates from Treasury-managed technical assistance. We are determined to develop a clear and useful system of progress indicators in close consultation with AID management.

The goal of the Treasury-managed technical assistance program is to facilitate market-oriented policy and institutional reforms in the financial institutions of the countries of Central and Eastern Europe and the former Soviet Union.

The policymaking process in every government involves a debate over the direction of policy and the interaction of interest groups to influence the outcome. In Central and Eastern Europe, foreign advisors can make a contribution to the advance of market-oriented reforms, but the contribution is likely to have only an incremental impact on the outcome. Moreover, in the policy process, the impacts of the most successful agents are often not clearly visible. Indeed, quiet work behind the scenes is often the most effective means to promote reform.

The impact of the technical assistance program depends on more than the quality and timing of the Treasury-provided assistance services. It depends on the receptivity of the country and its institutions to adopt reforms.

As a consequence, it seems logical to measure three distinct variables in order to assess the impact of the technical assistance program:

1. <u>The Conceptual Soundness of the Institutional Reform Program.</u> Is the quality of the reform program sound? Will the goals of the government's reform program advance the development of market-oriented private sector-led activity?

2. <u>The Institution's Track Record in Implementing Reform.</u> Is the government or agency implementing its reform program effectively and in a timely manner? Are obstacles being overcome?

3. <u>Contribution of the Treasury Technical Assistance Program.</u> Are Treasury technical assistance providers conveying useful ideas, that are not readily available in the country? Are working relationships sufficiently satisfactory to transmit ideas effectively? Are Treasury technical assistance providers exhibiting initiative and imagination to convey ideas?

Each resident advisor -- the basic unit of the Treasury-managed technical assistance program -- will be asked to prepare specific goals and milestones within four weeks of his/her arrival at post. These goals and milestones will be reviewed and accepted or modified by Treasury, in cooperation with AID. Progress toward achieving these goals will be evaluated periodically.

To evaluate the impact of its technical assistance program, the Treasury Department will convene an evaluation panel every six months to measure progress towards technical assistance goals for each of its activities. The panel will normally consist of the Director of the Office of Technical Assistance, the Director of the appropriate regional office, the country officer responsible for managing the assistance program for the country, the country desk officer responsible for analyzing reform efforts in the country, and functional Senior Advisor responsible for the activity. Under the Chairmanship of the Senior Advisor, the panel will review the suitability of the work plan and recommend adjustments where needed.

The results will be provided to the technical assistance providers and to the Agency for International Development and to the State Department Coordinator for assistance to the region, in confidence.

<u>Conclusion</u>

Your draft report makes a useful contribution to the management of our technical assistance programs. It calls attention to several areas where the Treasury-managed assistance program merits review and revision.

We also appreciate the several positive comments in your draft report about the program. The Treasury Department has had the good fortune to find and field excellent professionals in advisory and training positions. With strengthened management techniques, the output of the field personnel will doubtlessly be even better.

Sincerely,

DM Zelikow

Daniel M. Zelikow
Director
Office of Technical Assistance

Enclosure