

UNITED STATES  
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE  
INSPECTOR  
GENERAL

AUDIT OF THE CREDIT  
ACTIVITIES OF THE EARTHQUAKE  
RECONSTRUCTION PROJECT FOR  
THE YEAR ENDED SEPTEMBER 30, 1989

Audit Report No. 1-519-90-24-N  
May 14, 1990



Regional Inspector General for Audit  
TEGUCIGALPA

AGENCY FOR INTERNATIONAL DEVELOPMENT

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May 14, 1990

MEMORANDUM

TO: D/USAID/El Salvador, Henry H. Bassford

FROM: RIG/A/T, *Coinage N. Gothard*  
Coinage N. Gothard, Jr.

SUBJECT: Audit Report No. 1-519-90-24-N, "Audit of the Credit Activities of the Earthquake Reconstruction Project for the Year Ended September 30, 1989"

This report presents the results of a non-Federal financial audit of the Credit Activities of the Earthquake Reconstruction Project, USAID/El Salvador Project No. 519-0333, managed by the Central Bank of Reserve (BCR) and the National Housing Financier (FNV). The accounting firm of Price Waterhouse prepared the report, which is dated May 7, 1990.

The purpose of the project is to assist the Government of El Salvador and the private sector in repairing and reconstructing homes, businesses, basic services, and infrastructure damaged by the October 10, 1986 San Salvador Earthquake. The audit covered the year ended September 30, 1989, and included coverage of \$4,128,133 in A.I.D funds provided to the project.

The purpose of this audit was to report on (1) the fairness of the fund accountability statement for the year ended September 30, 1989; (2) the internal control structure; and (3) compliance with agreement terms and applicable laws and regulations.

In the opinion of Price Waterhouse, the fund accountability statement presents fairly, in all material respects, the loans granted under the credit activities. Nevertheless, the audit disclosed two questionable loans amounting to 70,000 colones (\$14,000). Price Waterhouse's study and evaluation of the internal control structure disclosed two weaknesses. One weakness, considered to be material, was that the savings and loan associations involved in the project did not maintain separate subsidiary accounting records to control the funds received

from the FNV. And the other weakness was a lack of adequate controls by the savings and loan associations to assure that duplicate loans were not granted to the same beneficiaries. In the opinion of Price Waterhouse, there was compliance with agreement terms and applicable laws and regulations, with respect to items tested, except for one material instance of noncompliance in which one savings and loan association - CRECE, S.A. - did not maintain adequate documentation to support the eligibility of loans granted under the project. Nothing came to their attention to indicate noncompliance with items not tested.

The draft report was discussed with USAID/El Salvador on March 13, 1990. The Mission provided written comments and additional documentation which resulted in modification of the final report.

The Price Waterhouse report contains three recommendations to improve internal controls and compliance. We have summarized the findings and related recommendations for inclusion in the Office of the Inspector General's audit recommendation follow-up system:

Recommendation No. 1

We recommend that USAID/El Salvador negotiate a settlement for the 70,000 colones (\$14,000) in questionable loans included in the Price Waterhouse report dated May 7, 1990.

Recommendation No. 2

We recommend that USAID/El Salvador assure that the National Housing Financier (FNV) improves the project's internal controls and compliance by:

- a. requiring the participating savings and loan associations to maintain separate subsidiary accounting records to control A.I.D. funds received and loans granted;
- b. ensuring that the participating savings and loan associations implement appropriate loan control systems to assure that duplicate loans are not granted; and
- c. requiring one savings and loan association - CRECE, S.A.- to obtain and maintain all documentation necessary to fully support the eligibility of loans granted.

Please advise this office within 30 days of actions planned or taken to clear the recommendations.

CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT No. 519-0333

FUND ACCOUNTABILITY STATEMENTS  
AS OF SEPTEMBER 30, 1989

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*Price Waterhouse*



May 7, 1990

Mr. Coinage N. Gothard, Jr.  
Regional Inspector General for Audit  
U. S. Agency for International Development  
Tegucigalpa, Honduras

Dear Mr. Gothard:

This report presents the results of our financial audit of the fund accountability statements for the year ended September 30, 1989, of the Credit Activities of the Earthquake Reconstruction Project, USAID/El Salvador Project No. 519-0333, managed by the Central Bank of Reserve (Banco Central de Reserva - BCR) and the National Housing Financier (Financiera Nacional de la Vivienda-FNV).

BACKGROUND

The Earthquake Reconstruction Project, USAID/El Salvador Project No. 519-0333, provided after amendments, \$98 million through September 30, 1991, to assist El Salvador in restoring the standard of living for individuals affected by the October 10, 1986, San Salvador earthquake. The project immediately followed the \$50 million Earthquake Recovery Program, USAID/El Salvador Project No. 519-0331, already completed. The new project provided a long-term solution to the destruction caused by the earthquake, whereas the initial project provided immediate and intermediate solutions over an approximate one year period.

The project purpose is to assist the Government of El Salvador (GOES), and the private sector to repair and reconstruct homes, businesses, basic services, and infrastructure in metropolitan zones most seriously affected by the earthquake. The project includes credit activities and the Restoration of Public Services Component.

The credit activities provided housing loans for repair and reconstruction of individual houses; reconstruction and rehabilitation of rooming houses for rental (mesones); and construction of new, low cost, condominium type apartments to replace rooming houses (mesones) as well as loans for private health services, private schools, and small businesses. The credit activities component's presently approved budget amounts to US\$14,390,000 while the original budget was US\$43,000,000.

The funds for the program's activities are jointly programmed by the U. S. Agency for International Development in El Salvador (USAID/El Salvador) and the GOES through its Ministry of Planning and Coordination for Economic and Social Development (Ministerio de Planificación y Coordinación del Desarrollo Económico y Social - MIPLAN). The funds are channelled through the Foreign Financing Technical Secretariat (Secretaría Técnica del Financiamiento Externo - SETEFE), acting as a general coordinator of foreign financing, and the Central Bank of Reserve (BCR) and the National Housing Financier (FNV), acting as depositary and administrator of the funds, respectively.

The housing loans component is administered as a discount credit line by the BCR to provide loans for housing repair and reconstruction activities through the FNV and the following seven selected savings and loan associations:

- (1) CRECE, S. A.
- (2) APRISA, S. A. (Ahorro, Préstamos, Inversiones, S. A.)
- (3) ATLCATL, S. A.
- (4) AHORROMET (Ahorros Metropolitanos, S. A.)
- (5) CASA (Construcción y Ahorro, S. A.)
- (6) CREDISIA (Crédito Inmobiliario, S. A.)
- (7) La Central de Ahorros, S. A.

The FNV is responsible for establishing overall credit policies and criteria including the creation of specific regulations, systems and procedures for the management of the funding, and for monitoring and evaluating the savings and loan associations' performance during implementation.

The business credit is managed by the commercial banks that expressed interest in participating in this program. A separate audit report was prepared regarding the Restoration of Public Services Component.

#### AUDIT OBJECTIVES AND SCOPE

We were engaged to conduct a concurrent financial audit of the fund accountability statements of the credit activities of the Earthquake Reconstruction Project, USAID/El Salvador Project No. 519-0333, managed by the Central Bank of Reserve (BCR) and the National Housing Financier (FNV) for the year ended September 30,

1989. Our audit was performed in accordance with generally accepted auditing standards and the United States Comptroller General's "Government Auditing Standards" (1988 Revision) and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary to determine whether:

1. The fund accountability statements for the credit activities of the Earthquake Reconstruction Project, USAID/El Salvador Project 519-0333, fairly present its financial position as of September 30, 1989, and that the funds provided by USAID/El Salvador as of that date were utilized in accordance with agreement terms.
2. The participating institutions' internal control structures were adequate for project purposes.
3. The GOES and the participating and coordinating entities complied with agreement terms and applicable laws and regulations which may affect the project's goals and costs.

The scope of our work consisted of:

1. Performing a selective review on a judgemental basis of documentation, accounting records, internal controls, and loan procedures.
2. Performing on-site tests, visits, inspections, and observations to determine eligibility of loans, made only to beneficiaries who suffered damage from the earthquake and only for repair and reconstruction of buildings damaged and/or destroyed by the earthquake.
3. Performing a selective examination of documentation supporting loans applied for, approved, and executed.
4. Reviewing the procedures used to control the funds, including their channeling from the Central Bank of Reserve (BCR) through the National Housing Financier to the participating savings and loan associations and to the beneficiaries.
5. Reviewing all financial and project reports.

## RESULTS OF AUDIT

### Fund Accountability Statements

The fund accountability statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

Although our audit disclosed two questionable loans amounting to ¢70,000 (US\$14,000), we considered them immaterial to the fund accountability statements, and consequently our opinion on those statements contains no qualification.

In our opinion, the fund accountability statements as of September 30, 1989 present fairly, in all material respects, the loans granted under the credit activities of the Earthquake Reconstruction Project, USAID/El Salvador Project No. 519-0333, for the year ended September 30, 1989, according to the basis of accounting described above.

#### Internal Control Structure:

In planning and performing our audit we considered the coordinating and implementing institutions' internal control structures in order to determine our auditing procedures for the purpose of expressing our opinion on the fund accountability statements and not to provide assurance on their internal control structures.

Our evaluation of the Credit activities' internal control structure included the following major categories: 1) Loans selection and approval 2) bank accounts and reconciliations; 3) controls over subproject progress; 4) controls over project equipment; and 5) payrolls. Our evaluation disclosed the following matters involving the project's execution that we consider reportable conditions:

1. Lack of controls to assure that loan applicants do not obtain duplicate loans from the Earthquake Reconstruction Project funds.
2. Lack of subsidiary records to control project funds.

#### Compliance with Agreement Terms and Applicable Laws and Regulations

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of compliance by the Central Reserve Bank, the National Housing Financier, and the implementing financial institutions with agreement terms and applicable laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

Our tests of compliance disclosed the following material instance of noncompliance:

1. Loan files without complete and appropriate documentation.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, the Central Reserve Bank, the National Housing Financier, and the implementing financial institutions complied, in all material respects, with agreement terms and applicable laws and regulations. With respect to items not tested, nothing came to our attention that caused us to believe that the Central Reserve Bank, the National Housing Financier, and the implementing financial institutions had not complied, in all material respects, with those provisions.

U. S. AGENCY FOR INTERNATIONAL DEVELOPMENT  
MISSION TO EL SALVADOR COMMENTS

USAID/El Salvador provided written comments which are included as Annex I. The final report was modified based on these comments and additional documentation provided subsequent to the exit conference held on March 13, 1990.

*Pricewaterhouse* \* \* \*

*Price Waterhouse*



CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT No. 519-0333

FUND ACCOUNTABILITY STATEMENTS  
AS OF SEPTEMBER 30, 1989

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying fund accountability statements of the credit activities of the Earthquake Reconstruction Project, USAID/El Salvador Project No. 519-0333, for the year ended September 30, 1989. These statements are the mutual responsibility of the management of the Central Reserve Bank, the National Housing Financier, and the implementing financial institutions. Our responsibility is to express an opinion on the fund accountability statements based on our audit.

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

As described in Note 1, these fund accountability statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion the fund accountability statements present fairly, in all material respects, the loans granted under the credit activities of the Earthquake Reconstruction Project, USAID/El Salvador Project No. 519-0333, for the year ended September 30, 1989, according to the basis of accounting described in Note 1.

This report is intended solely for the use of the Central Reserve Bank, the National Housing Financier, and the United States Agency for International Development. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

*Price Waterhouse*

December 27, 1989

CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT No. 519-0333  
FUND ACCOUNTABILITY STATEMENT BY SUB-COMPONENT  
YEAR ENDED SEPTEMBER 30, 1989

	<u>Budget</u>		<u>Actual</u>		<u>Questioned Loans (Note 3)</u>
	<u>U.S. dollars</u>	<u>Salvadoran colones</u>	<u>U.S. dollars</u>	<u>Salvadoran colones</u>	
<b>Receipts:</b>					
<b>Housing Credit -</b>					
Repair/reconstruction/ upgrade			\$ 564,861	¢ 2,919,176	
Apartments/houses for sale or rent			<u>3,359,272</u>	<u>17,456,139</u>	
			<u>3,924,133</u>	<u>20,375,315</u>	
<b>Business Credit -</b>					
Small businesses			36,000	180,000	
Private schools			116,000	580,000	
Private medical facilities			<u>52,000</u>	<u>260,000</u>	
			<u>204,000</u>	<u>1,020,000</u>	
			<u>4,128,133</u>	<u>21,395,315</u>	
<b>Disbursement and/or cash advances to the implementing financial institutions</b>					
<b>Housing Credit -</b>					
Repair/reconstruction/ upgrade	\$ 3,880,000	¢19,400,000	645,801	3,289,863	¢ 70,000
Apartments/houses for sale or rent	<u>10,010,000</u>	<u>50,050,000</u>	<u>3,087,362</u>	<u>15,957,769</u>	<u>                    </u>
	<u>13,890,000</u>	<u>69,450,000</u>	<u>3,733,163</u>	<u>19,247,632</u>	<u>70,000</u>
<b>Business Credit -</b>					
Small businesses	100,000	500,000	14,000	70,000	
Private schools	250,000	1,250,000	112,000	560,000	
Private medical facilities	<u>150,000</u>	<u>750,000</u>	<u>52,000</u>	<u>260,000</u>	<u>                    </u>
	<u>500,000</u>	<u>2,500,000</u>	<u>178,000</u>	<u>890,000</u>	<u>                    </u>
	<u>\$14,390,000</u>	<u>¢71,950,000</u>	<u>3,911,163</u>	<u>20,137,632</u>	<u>¢ 70,000</u>
<b>Represented by cash in banks in BCR and FNV</b>					
			<u>\$ 216,970</u>	<u>¢ 1,257,683</u>	

**CREDIT ACTIVITIES OF THE EL SALVADOR EARTHQUAKE  
RECONSTRUCTION PROJECT USAID/EL SALVADOR  
PROJECT No. 519-0333**

**FUND ACCOUNTABILITY STATEMENT BY IMPLEMENTING FINANCIAL INSTITUTIONS  
FOR THE YEAR ENDED SEPTEMBER 30, 1989  
(expressed in Salvadoran colones)**

Loan Disbursements by Sub-component

<u>Institutions</u>	<u>Fund receipts</u>	<u>Repair/ reconstruction/ upgrade</u>	<u>Apartment houses for sale or rent</u>	<u>Small businesses</u>	<u>Private schools</u>	<u>Private medical facilities</u>	<u>Total disbursements</u>	<u>Balance of receipts over (under) disbursements</u>	<u>Questionable Loans (Note 3)</u>
<b>Housing credit:</b>									
AHORROMET	₡ 9,072	₡ 9,072					₡ 9,072		
CASA	1,849,645	392,100	₡ 1,376,300				1,768,400	₡ 81,245	₡30,000
CRECE	1,448,765	1,189,543	752,830				1,942,373	(493,608)	
CREDISA	480,060	419,060	-				419,060	61,000	
APRISA	1,458,321	-	1,450,075				1,450,075	8,246	
La Central de Ahorros	228,800	20,000	208,800				228,800	-	
ATLACATL	<u>13,772,969</u>	<u>1,322,055</u>	<u>12,364,368</u>				<u>13,686,423</u>	<u>86,546</u>	<u>40,000</u>
	<u>19,247,632</u>	<u>3,351,830</u>	<u>16,152,373</u>				<u>19,504,203</u>	<u>(256,571)</u>	<u>70,000</u>
<b>Businesses Credits:</b>									
Banco Cuscatlán	350,000	-	-	₡70,000	₡ 60,000	₡220,000	350,000	-	
Banco Hipotecario	500,000	-	-	-	500,000	-	500,000	-	
Banco Capitalizador	40,000	-	-			40,000	40,000		
	<u>890,000</u>	<u>-</u>	<u>-</u>	<u>70,000</u>	<u>560,000</u>	<u>260,000</u>	<u>890,000</u>	<u>-</u>	
	<u>₡20,137,632</u>	<u>₡3,351,830</u>	<u>₡16,152,373</u>	<u>₡70,000</u>	<u>₡560,000</u>	<u>₡260,000</u>	<u>₡20,394,203</u>	<u>₡(256,571)</u>	<u>₡70,000</u>

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CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT No. 519-0333

NOTES TO THE FUND ACCOUNTABILITY STATEMENTS  
FOR THE YEAR ENDED SEPTEMBER 30, 1989

NOTE 1 - NATURE OF OPERATIONS AND

ACCOUNTING POLICIES:

The purpose of the Credit Activities of the Earthquake Reconstruction Project was to assist the Government of El Salvador (GOES) in financing the following activities:

1. provide credit for individual home and apartment repairs and for repair and reconstruction of rooming houses (mesones) and,
2. provide credit to help revitalize small enterprises in the commercial sector as well as to repair private educational and medical facilities which were seriously damaged by the earthquake.

The significant accounting practices and policies adopted by the Central Reserve Bank (BCR), the National Housing Financier (FNV), and the participating implementing financial institutions to record the component's transactions, do not necessarily reflect the application of accounting principles generally accepted in the United States of America. The BCR, FNV, the commercial banks, and savings and loan associations, recorded the component's transactions through their own accounting systems, generally, using ledger accounts on a cash basis. The fund accountability statements reflect the balances of cash, receipts and disbursement of loans granted as of September 30, 1989.

NOTE 2 - CURRENCY EXCHANGE:

The participating implementing financial institutions maintain their records in Salvadoran colones, the legal currency of El Salvador. Since January 22, 1986, the official rate of exchange has been ¢5.00 to US\$1.00. Effective July 26, 1989 El Salvador Government authorized the banking system to purchase and sell United States dollars at exchange rates established by the supply and demand of U.S. currency that differ from the above mentioned official rate of exchange. At September 30, 1989, the exchange rates in the banking system for purchasing and selling United States dollars were ¢6.35 and ¢6.37 to US\$1, respectively. The accompanying fund accountability statements have been translated into U.S. dollars using the exchange rates prevailing at the dates of disbursements by the Central Reserve Bank.

NOTE 3 - QUESTIONABLE LOANS:

The following loans are considered questionable. Questionable loans include loans considered ineligible under the terms of the agreement (questioned) and loans which lack documentation and/or did not comply with all approving processes (suspended).

The following loans were questioned because of departures from agreement and administrative contract terms:

<u>Number of loans</u>	<u>Explanation</u>	<u>Amount</u>
1	Loan granted for repairing a house which apparently was not damaged by the earthquake <u>CASA</u> Loan N° 29367 to Vilma C. Chávez de Aldana	<u>Q30,000</u>
1	Loan granted in November 1988 and not fully used as of September 30, 1989 <u>ATLACATL</u> Loan N° 4-01-18-7 to Lucia Barraza Molina de Murcia	<u>40,000</u> <u>Q70,000</u>

*Price Waterhouse*



CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT No. 519-0333

INTERNAL CONTROL STRUCTURE

INDEPENDENT AUDITOR'S REPORT

We have audited the fund accountability statements of the credit activities of the Earthquake Reconstruction Project, USAID/El Salvador Project No. 519-0333, for the year ended September 30, 1989, and have issued our report thereon dated December 27, 1989.

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

In planning and performing our audit of the fund accountability statements of the credit activities of the El Salvador Earthquake Reconstruction Project, for the year ended September 30, 1989, we considered the coordinating and implementing institutions' internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the fund accountability statements and not to provide assurance on their internal control structure.

The management of the Central Reserve Bank, the National Housing Financier and the implementing financial institutions are responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the fund accountability statements. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any

evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report we have classified the significant internal control structure policies and procedures in the following categories: 1) Loans selection and approval 2) bank accounts and reconciliations; 3) controls over subproject progress; 4) control over project equipment; and 5) payrolls.

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

Our evaluation of the Credit activities' internal control structure, disclosed certain matters involving the project's execution that we consider reportable conditions in accordance with generally accepted auditing standards and the United States Comptroller General's "Government Auditing Standards" (1988 Revision). These reportable conditions are described in findings number 1 and 2 in the following pages of this report, and involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the implementing financial institutions' ability to record, process, summarize, and report financial data consistent with the assertions of management in the fund accountability statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the fund accountability statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. In this connection finding 2 is deemed to be a material weakness.

Our consideration of the internal control structure would not necessarily disclose all matters that might be reportable conditions and accordingly would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above.

This report is intended solely for the use of the Central Reserve Bank, the National Housing Financier, and the United States Agency for International Development. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

*P. Rice Waterhouse*

December 27, 1989

CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT No. 519-0333

REPORT ON INTERNAL CONTROL STRUCTURE

FINDINGS

1. Lack of Controls to Assure That Loan Applicants do not Obtain Duplicate Loans from the Earthquake Reconstruction Project Funds.

**Condition:**

Participating savings and loan associations did not maintain cross-referenced information concerning loans granted to beneficiaries with Earthquake Reconstruction Project funds. Consequently, there was some risk that duplicate loans could have been granted to the same beneficiary.

**Criteria:**

Loan applicants and family groups should not obtain more than one loan from Earthquake Reconstruction Project funds.

**Cause:**

Lack of an updated and adequate information system that could provide the above mentioned data.

**Effect:**

While our concurrent audit did not identify loans duplicated, the risk exists that applicants could obtain several loans with project funds which could be considered questionable loans.

**Recommendation:**

USAID/El Salvador should request the National Housing Financier (FNV) to implement an appropriate loan information system in order to assure cross-referencing for loan applicants and to avoid approval of more than one loan for the same applicant with project's funds.

## 2. Lack of Subsidiary Records to Control Project Funds.

### Condition:

Savings and loan associations did not maintain separate subsidiary records to control funds received from FNV, loans granted, and the balance at month's end.

### Criteria:

The savings and loans associations are required to maintain separate and specific records to control financial information for funds received from FNV and loans granted, to facilitate preparation of the reports required by FNV.

### Cause:

In general, management overlooked this requirement.

### Effect:

Because we conducted a concurrent audit which included on-site tests and other monitoring steps, it was possible to identify the financial activities related to the project. However, the lack of separate accounting records does not permit, after-the-fact, proper control of the financial activities and reflows of cash of the housing credit line managed by the savings and loan associations.

### Recommendation:

USAID/El Salvador and the National Housing Financier should request the savings and loan associations to establish appropriate accounting records to control the line of credit operations. These records should be kept current and adequately reviewed by responsible officials of each participating savings and loan association.

*Price Waterhouse*



CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT N° 519-0333

COMPLIANCE WITH AGREEMENT TERMS  
AND APPLICABLE LAWS AND REGULATIONS

INDEPENDENT AUDITOR'S REPORT

We have audited the fund accountability statements of the credit activities of the Earthquake Reconstruction Project, USAID/El Salvador Project N° 519-0333, managed by the Central Reserve Bank (BCR), the National Housing Financier (FNV), and the implementing financial institutions for the year ended September 30, 1989, and have issued our report thereon dated December 27, 1989.

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

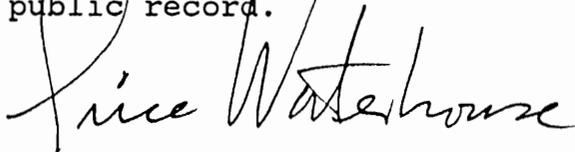
The management of the Central Reserve Bank, the National Housing Financier, and the implementing financial institutions are responsible for compliance with terms of the agreement and with applicable laws and regulations. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of compliance by the Central Reserve Bank, the National Housing Financier, and the implementing financial institutions with agreement terms and applicable laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

Material instances of noncompliance are failures to follow agreement terms and applicable laws and regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material with respect to the fund accountability statements. The results of our tests of compliance disclosed the material instance of noncompliance described in finding No. 1, the effect of which has been disclosed in the fund accountability statements.

We considered this material instance of noncompliance in forming our opinion on whether the fund accountability statements mentioned above are presented fairly, in all material respects, in conformity with the accounting basis mentioned in Note 1 to such statements. This report does not affect our report dated December 27, 1989 on those fund accountability statements.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, the Central Reserve Bank, the National Housing Financier, and the implementing financial institutions complied, in all material respects, with the provisions referred to in the third paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that the Central Reserve Bank, the National Housing Financier, and the implementing financial institutions had not complied, in all material respects, with those provisions.

This report is intended solely for the use of the Central Reserve Bank, the National Housing Financier, and the United States Agency for International Development. This restriction is not intended to limit distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

A handwritten signature in cursive script that reads "Price Waterhouse". The signature is written in dark ink and is positioned above the date.

December 27, 1989

CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT No. 519-0333

REPORT ON COMPLIANCE WITH AGREEMENT TERMS  
AND APPLICABLE LAWS AND REGULATIONS

FINDING

1. Loan Files Without Complete and Appropriate Documentation.

**Condition:**

Files of loans granted by CRECE for acquiring housing units built by the Cooperative Housing Foundation (CHF) lack documents in support of the applicants' claims that in fact, they were affected by the earthquake of October 10, 1986.

**Criteria:**

Section 2.3 of FNV procedures and regulations to grant loans with project funds, states that the participant savings and loan associations should verify that loan applicants were, in fact, affected by the earthquake of October 10, 1986.

**Cause:**

The CRECE General Manager represented that CHF had performed all the pertinent investigations to verify that the loan applicants were affected by the earthquake of October 10, 1986.

**Effect:**

Loans to non-eligible applicants are considered questionable.

**Recommendation:**

USAID/El Salvador should request CRECE to obtain from the Cooperative Housing Foundation all the documents supporting its investigation on eligibility of applicants, and include these documents in the loan files maintained by CRECE.

\* \* \*

CREDIT ACTIVITIES OF THE EL SALVADOR  
EARTHQUAKE RECONSTRUCTION PROJECT  
USAID/EL SALVADOR PROJECT No. 519-0333

LIST OF REPORT RECOMMENDATIONS

INTERNAL CONTROL STRUCTURE

Recommendation 1:

USAID/El Salvador should request the National Housing Financier (FNV) to implement an appropriate loan information system in order to assure cross-referencing for loan applicants and to avoid approval of more than one loan for the same applicant with project's funds.

Recommendation 2:

USAID/El Salvador and the National Housing Financier should request the savings and loan associations to establish appropriate accounting records to control the line of credit operations. These records should be kept current and adequately attested by responsible officials of each participating savings and loan association.

COMPLIANCE WITH AGREEMENT TERMS AND APPLICABLE LAWS AND  
REGULATIONS

Recommendation 1:

USAID/El Salvador should request CRECE to obtain from the Cooperative Housing Foundation all the documents supporting its investigation on eligibility of applicants, and include these documents in the loan files maintained by CRECE.

## memorandum

DATE: April 11, 1990

ANNEX IREPLY TO  
ATTN OF:Richard K. Archi, D/DIR, USAID/ES *Archi*

SUBJECT:

Mission Response to the Draft Audit Report on the  
Fiscal Year 1989 Activities of Project 519-0333

TO: Mr. Coinage Gothard, RIG/A/T

The following represents the Mission's response to the above draft audit report. Page references are from the draft report presented at the Exit Conference held on 3/13/90.

## I. GENERAL

The Earthquake Reconstruction Project is complicated by almost all the typical host country management and technical challenges indigenous to assistance grant construction projects. This project dealt with issues and demands over a wide spectrum. Subprojects are being executed or are subjected to some degree of control by at least six ministries, several GOES autonomous agencies, seven savings and loan associations, the Central Bank, (BCR) and National Housing Financier (FNV), three Private Voluntary Organizations and the Municipality of San Salvador. Several local private groups are also involved in one way or another. These are in addition to the Ministry of Planning, the DGR, SETEFE and the Court of Accounts. Most of these entities are in a developing stage as to their systems of control and record-keeping. This project is serving to increase their capabilities in these areas as well as performing its stated objectives.

The great range in number, nature, purpose and location of subprojects makes close monitoring of the quality and progress of subprojects design, construction and inspection very difficult. It is tacitly, or as a matter of necessity, assumed that critical project functions will be performed by the Salvadoran governmental entities involved, in accordance with discussions and agreements between AID and the respective entities. Institutional deficiencies in government agencies in the developing world are neither new nor unique to this project, but the

number of agencies involved and the great number of subprojects with which several agencies are concerned generate a high volume of situations which should be closely monitored. Presented below are examples of some of this project's activities:

- There are approximately 200 different sites where schools are being repaired or completely demolished and rebuilt, of which at least 100 remain to be built. Contracts for a few of the more recently identified schools for design are yet to be let. These activities range in complexity from construction of a few classrooms to the complete construction of new institutions complete with libraries, laboratories, offices, and grounds improvements. Additional sites are still being identified and added to the program.
- There are seven different sites where major health facilities are being repaired or reconstructed, and some of them are quite complex. While some have been completed, one remaining large project is just now going to design, and two are yet to be constructed.
- There are six multi-million dollar market complexes being built anew, one has been completed and another is nearing completion. Eight major market structures are to be repaired or replaced and some smaller markets have been renovated.
- There are relocation villages at five sites where streets, sidewalks, drainage, utilities and retaining walls as well as houses are being built, involving housing units numbering in the thousands. Any one of these relocation projects could be a major A.I.D. project in its own right.
- There is work at an important water supply and treatment facility that will provide water through the ANDA system for three relocation villages and large portions of San Salvador. The complexities of the project are such that careful management and engineering oversight is required to assure that the resulting plant will reliably meet water output volume and quality requirements. This is also a multi-million dollar project.

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- There is also a major highway project. It is not complex but still requires regular monitoring to ensure optimum use of resources during implementation.
  
- The Housing Credit Component of the project involves construction on 31 different sites, plus major repairs on some undetermined portion of 77 large apartment buildings. Each of the 31 sites involves a number (from 11 to 450) of family housing units. Numerous others will be smaller. Construction on ten of the housing subprojects has been completed. Now, qualifying applicants requires constant attention and effort. Construction is about to begin on twelve more of the thirty-one sites and five others are approximately 50% completed. Quality control on construction of housing projects is difficult because there exists no national or municipal building code enforcement authorities in El Salvador as yet. Because of this, each of 31 savings and loan association and PVO housing sites constitutes a self-contained sub-division or townsite addition and, therefore, requires careful inspections to assure that construction standards are met and public safety is protected.

We present the foregoing list of activities to describe the magnitude and complexity of the institutional setting in which the Earthquake Reconstruction Project is being implemented. We also provide this background to urge the Regional Inspector General (RIG) to critically evaluate the 19 "findings" presented in the draft report. As we discussed in the Exit Conference many of these findings are presented as "nice things to do" but do not represent weaknesses in key control areas or are mitigated by other controls. Obviously, much more in the nature of institutional reform can always be done but resources should be concentrated on only the most pertinent findings. Furthermore, we recognize that the ideal should not be demanded of developing implementing entities, therefore, the Mission has opted to focus on the essential controls instead, a goal which we believe that we are achieving.

The Price Waterhouse auditors commented that "the results of this audit were the best of all the audits performed on this Mission in their four-year audit experience here." We do not see this statement reflected in the report and it is hard to find the thrust of that statement even when reading between the lines. The Mission hopes that the

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readers of the audit report will have an appreciation for the difficulty of the operational setting, the enormity of the work in progress and the minor nature of the audit findings when juxtapositioned against the organizational backdrop.

The objectives of this project are that: 1) the Earthquake Reconstruction of San Salvador should take place; to leave everything on the ground destroyed and in rubble is not an considered to be acceptable option, 2) reconstruction must also take place within the exiting capacities of the host government agencies, 3) the project must be implemented with the reasonable assurance that grant resources are used for intended purposes.

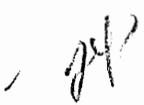
AID believes that it has mitigated this difficult situation by developing an interinstitutional system for implementation which makes the best use of the private and public sectors, both formal and informal, and incorporates a hierarchy of project oversight that involves (i) the implementing entities, (ii) private sector supervisors, (iii) contractors, (iv) a coordinating entity (MIPLAN, DGR), (v) the financial entity (AID), (vi) a special audit team from the Court of Accounts and (vii) a non-federal audit team from Price Waterhouse providing a concurrent review of all components of the project as they progress. The project despite its magnitude, complexity, and organizational setting is working and working very well. The conclusion that Mission management hopes can be reached from the audit report is that implementation problems have been detected and resolved in a routine manner. Nearly all of the situations mentioned in this audit report are matters which the Mission had identified, had developed strategies for resolving, and had already resolved before the issuance of the audit report.

## II. NON CREDIT ACTIVITIES

### A. Questioned Costs:

Ø83,595 in total (\$16,719 at 5:1)

School roofing materials were used which contained asbestos in violation of the grant agreement. This variance was uncovered as a result of the project's normal system of oversight and has been corrected at no additional cost to the project (See Annex I). Since this problem was detected and resolved within the normal operations of the project, the related costs should not be "questioned" in the draft report. The Mission requests that these costs be reclassified as allowable.



B. Suspended Costs:

Ø2,074,184 in total (\$414,836.80 at 5:1)

<u>Description</u>	<u>Amount</u>
1. Damaged Equipment	Ø866,595

The amount reported here represents the total cost of the equipment rather than the approximate amount of the damage, or about \$4,000. Presenting the inflated figure in the draft report is misleading. Both the insurance companies and the respective suppliers have agreed to defray the costs for making the repairs and have issued letters, checks and have offered payment in cash to that effect. The repairs have not been made but they will be as soon as the stateside supplier delivers the needed parts and accessories. They are on order.

It is important to note that these damages were detected in the normal system of project oversight and resolution is following normal procedures as well (see Annex II). The suspended cost amount should be reduced to the amount of the damages or approximately \$4,000.

2. Unliquidated Costs	Ø1,207,589
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In our opinion, funds in process of liquidation should not constitute questioned or suspended costs. Unliquidated advances are unbilled receivables which are converted to expenditures as soon as the documentation is submitted for their liquidation (see Annex III).

There is nothing "questionable" about unbilled costs on a construction project. Anytime a reporting cut-off date is selected in mid-project (9/30/89 in this case) there will always be costs incurred but not yet billed. The Mission requests that the Regional Inspector General (RIG) instruct the CPA firms under its direction not to question unbilled costs unless they exhibit problems which would prevent them from being billed and liquidated in the ordinary course of business.

C. Other Findings:

Again, the Mission would like to stress the importance of identifying weaknesses in key controls vs. presenting points that "would be a good idea." While project management appreciates being apprised of the latter they are not considered pertinent enough to warrant official recommendations from the RIG. For example, at the Exit Conference the issue of timely bank reconciliations was discussed. Mission personnel asked the representatives of the CPA firm if the accounts were reconciled as of the reporting date (9/30/89) and if any problematic reconciling items were found. They replied that they were reconciled and no problems were noted. More timely bank reconciliations would detect problems sooner (although none have been noted) but year-end reconciliation ensure that they will be detected at least annually.

III. CREDIT ACTIVITIES:

A. Questioned Costs:

¢10,253,821 in total (\$2,050,764.20 at 5:1)

<u>Description</u>	<u>Amount</u>
1. Las Conchas project	¢9,828,884

The Las Conchas housing development project has been a controversial project. It first came under question by AID management in July of 1988 when Salvadoran cabinet members questioned the construction of a housing project on what was allegedly a national forest reserve. AID's investigation revealed that the project had been duly approved by the national regulatory authorities but that the slopes and precipitous grades were such that special precautions were required during construction in order to minimize disturbances to the ecology and in order to provide safety relief to the inhabitants of the area.

In order to insure proper construction, AID conducted a number of meetings with the FNV, the respective savings and loan association, the contractor, DUA and the DGR in July and August of 1988 to outline practices to be used and precautionary measures to be implemented during construction.

Despite the continuous admonitions of AID to the contractor and the various governmental entities, proper protective measures were not developed and program construction practices outlined by AID and agreed to by the contractor were not observed. After a long series of meetings in early 1989, AID withdrew its financing to the project recognizing that the contractor would not be able to develop adequate protective works without exceeding the Q30,000 per unit cost ceiling for this project.

On May 26, 1989 a special agreement was reached among the Ministry of Planning, AID, the FNV and the respective savings and loan association. Basically, AID withdrew participation in order to permit the contractor to develop the proper protective measures and charge them to the project irrespective of individual unit costs so that safety would not have to be sacrificed on the site in order to stay within the Q30,000 ceiling and so that the contractor would not have to suffer financial losses on the project by building the protective measures and going bankrupt as a result of the additional investment. Agreement was reached to substitute other earthquake eligible housing units for the purposes of liquidating the short-term construction advance of Q9.8 million made to the contractor of Las Conchas. Please find a copy of this agreement as presented in Annex IV.

A few days later, on June 2, 1989 a new administration took control of the government and personnel in the key entities (FNV, the S&L, the DGR and MIPLAN) were replaced. This necessitated numerous meetings to apprise the newly appointed government personnel of the problem and to develop a strategy and procedures for resolving the issues related to identifying and approving earthquake eligible mortgages in substitution for the construction advance at Las Conchas.

A number of difficulties have been experienced in resolving the issues associated with the Las Conchas activity, i.e., the transition of one government administration to another one, a complete turnover of key personnel, the military conflict in the area to be substituted (Las Cañas is in Soyapango), and the official governmental year-end recess. Nevertheless, a solution has been found. The FNV, Atlacatl and AID have identified earthquake eligible replacement loans amounting to

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¢4,962,075. They have been accepted as liquidation for approximately one half of the outstanding advance. A bill-for-collection has been presented to the FNV for the difference, ¢4,866,809.41, and Atlacatl has deposited that amount to FNV's account at the BCR.

The Mission objects to the manner in which the draft audit report presents the Mission's management of this most complex matter. The conclusion that the Mission's supervisory capacity has been deficient on this issue, ignores the active and aggressive role that the Mission has played since July of 1988 in identifying the problem and pursuing it through to a judicious and satisfactory solution for everyone. Although representatives of the CPA firm have had the opportunity to review the correspondence and files, have attended many mission organized meetings on the subject, and have had several oral presentations of the mission's participation in a solution to this problem, no mention of Mission's efforts is evident in the draft report. Annex IV attached represents the exchange of selected correspondence and in no way covers the numerous meetings and negotiating sessions which were held with the Chamber of Construction Industry, the Association of Salvadoran Engineers, regulatory institutions, the contractor, independent consultants and others.

In conclusion, the reporting of the Mission's efforts on this issue should reflect that this is a positive example of how aggressive Mission management has resolved complex implementation problems. To this end, the amount of the eligible loans which have been substituted for, or ¢4,962,075, should be reclassified as allowable. The remaining ¢4,866,809, since it has been recovered and is on deposit, should be reclassified in the draft report as an outstanding advance.

2. Questioned Loans (14) ¢424,937

The Mission has reviewed these fourteen loans and has found ten of them to be eligible (see Annex VI). The remaining four loans should be questioned at this time pending further investigation. Please amend your draft report to reflect the above acceptances.

B. Suspended Costs:

Ø208,800 in total (\$41,760 at 5:1)

These costs relate to the Los Diplomáticos condominium project. There arose a disagreement between the financial entity, the savings and loan association and the contractor with respect to the specifications of the foundations and the design standards for the structure. This difference in opinion led the financial entity to interrupt construction until agreement could be reached.

This kind of disagreement is not unusual, but because there was an impasse, AID withheld further disbursements to the project in December of 1989 and encouraged the FNV to intervene in search of a mutual solution. Pursuant to AID's discussions with FNV, a local structural engineer was contracted to do an analysis and suggest remedial work as necessary.

The specified review was conducted and a redesign and retro-fit were accomplished. Once agreement was reached and project construction resumed, funding was reinstated and the activity has progressed normally since that time (See Annex V).

There are virtually hundreds of physical projects under construction in the Earthquake project. Problems of this order of magnitude occur frequently. They occur, are detected and are resolved within a reasonable length of time. The Mission can not prevent problems of this sort from occurring, nor do they seem to qualify as audit findings. It is misleading to the readers of this draft audit report to list as questioned costs any cost which relates to an issue under discussion or redesign. The Mission requests that these costs be reclassified as allowable.

C. Other findings:

See Section II.C.

APPENDIX II

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