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AUDIT OF  
USAID/COSTA RICA'S  
MANAGEMENT OF SELECTED MISSION ACTIVITIES

AUDIT REPORT NO. 1-515-86-20

June 20, 1986

**AGENCY FOR INTERNATIONAL DEVELOPMENT**

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June 20, 1986

MEMORANDUM FOR: USAID/Costa Rica Director, Daniel A. Chaij  
FROM : RIG/A/T, *Coinage N. Gothard* Coinage N. Gothard  
SUBJECT : Audit of USAID/Costa Rica's Management of Selected Mission Activities, Audit Report No. 1-515-86-20

This report presents the results of an audit of selected aspects of USAID/Costa Rica's management of Mission activities.

Background

The audit was performed because of certain systemic problems noted during our survey of USAID/Costa Rica's Agrarian Settlement and Productivity Project (515-0148). That audit was made in February and March of 1986 and is the subject of a separate report (see report No. 1-515-86-19). The problems identified at that time were:

- Active loan agreements contained language under Section 8.4, "Rate of Exchange," that was inconsistent with the standard language in AID Handbook 3, App. 6 A-1, page 12 as well as the terms of Section V of the December 22, 1961 Bilateral Agreement between the United States and Costa Rica.
- Cash advance procedures were not in compliance with AID Handbook 19, Appendix 1B, Section B3.d. (2).
- The Mission's contractor files were lacking key documentation needed for effective personnel management.

Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a limited scope compliance audit of selected USAID/Costa Rica's management practices. Audit objectives were to determine whether loan agreement provisions concerning "Rate of Exchange," management of cash advances, and documentation in contractor files were in compliance with AID policy.

To accomplish the audit objectives, we reviewed loan and grant agreement language for all active projects; management of cash advances for all active loans and selected grants; personal services and non-personal services contractor files; and we interviewed responsible USAID/Costa Rica officials.

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This audit was made in February and March 1986 and covered the period from July 1979 through March 1986. It included coverage of \$5,222,990 of AID funds. The audit was made in accordance with generally accepted government auditing standards.

### Results of Audit

Loan Agreement Exchange Rate Provisions Inconsistent with AID Policy - USAID/Costa Rica's January 31, 1986 "Financial Status of Loan Program" report included eight active loan agreements. Four of those loan agreements contained language under Section 8.4, "Rate of Exchange," that was inconsistent with the standard language in AID Handbook 3, App. 6 A-1, page 12, as well as the terms of Section V of the December 22, 1961 Bilateral Agreement.

The December 22, 1961 agreement between the United States of America and Costa Rica for "Economic, Technical and Related Assistance" stated under Article V that:

Funds used for purposes of furnishing assistance hereunder shall be convertible into currency of Costa Rica at the rate providing the largest number of units of such currency per U.S. dollar which, at the time conversion is made, is not unlawful in Costa Rica.

Standard language in A.I.D. Handbook 3 regarding exchange rates is consistent with the Bilateral Agreement. Handbook 3, App. 6 A-1 states that language under Section 8.4 "Rate of Exchange" should read as follows:

Except as may be more specifically provided under Section 8.2, if funds provided under the loan are introduced into (name of the country) by A.I.D. or any public or private agency for purposes of carrying out obligations of A.I.D. hereunder, the Borrower will make such arrangements as may be necessary so that such funds may be converted into currency of (name of country) at the highest rate of exchange which, at the time the conversion is made, is not unlawful in (name of country).

In four of the Mission's active loan agreements the language under Section 8.4 was written in such a way as to raise the possibility that dollars might not always be converted into local currency at the highest rate of exchange which, at the time the conversion is made, is not unlawful in Costa Rica. For example, Section 8.4 of loan 515-T-041 Northern Zone Infrastructure Development, dated July 19, 1983 states:

If funds provided under the Loan are introduced into Costa Rica by A.I.D. or any public or private agency for purposes of carrying out obligations of A.I.D., hereunder, the Borrower will make such arrangements as may be necessary so that such funds may be converted into local currency at the highest official rate of exchange, established by the Central Bank of Costa Rica, which is in effect at the time conversion is made. (emphasis added.)

Reference to the highest rate which is not unlawful is important in the context of this discussion because that formulation has a precise purpose, as set forth in AID Handbook guidance. The Agency's statement of policy on this is found on page 6B-18, Appendix 6B, AID Handbook

(The formulation of 'highest rate . . . which . . . is not unlawful' is used rather than 'highest legal rate' because the latter formulation in some countries may be equated with 'highest official rate.' The 'official rate' in such countries may be lower than e.g., prevailing and lawful business rate.)

In addition to loan 515-T-041, the following loan agreements contained rate of exchange language under Section 8.4 that was not consistent with the Handbook 3 standard language:

<u>Loan No. and Date</u>	<u>Project</u>
515-W-030 7-30-79	Science and Technology
515-T-032 9-13-79	Natural Resources Conservation
515-T-034 9-26-80	Agrarian Settlement and Productivity

Mission staff that we talked to on the exchange rate language issue said that the loans were signed prior to the arrival of current project officers. Hence we were not given clear reasons why the language in those four loan agreements deviated from the standard Handbook language. Grant agreements we reviewed followed the standard formulation.

The AID Bilateral Agreement in Costa Rica provides that dollars are to be converted at the highest rate not unlawful. Nevertheless, as has been shown in several LAC countries <sup>1/</sup>, that agreement does not effectively guarantee the best rate of exchange will be used. This is especially true if individual project agreement language clouds the meaning of the Bilateral Agreement on exchange rates. A recent policy statement from AID's Assistant Administrator for Latin America (State 030295 dated January 1986) further reinforces the need to use the standard AID exchange rate provision.

Our review did not disclose instances where USAID/Costa Rica was converting loan dollars at less than the highest rate that was not unlawful. Nevertheless, the potential existed that, given the language found in Section 8.4 of loans 030, 032, 034 and 041, problems could occur between the Central Bank of Costa Rica and AID, if Costa Rica should return to a dual exchange rate system.

#### Recommendation No. 1

We recommend that USAID/Costa Rica take appropriate steps to conform Section 8.4 (Rate of Exchange) of its current and future loan agreements with the standard language in AID Handbook 3, Appendix 6 A-1, page 12.

<sup>1/</sup> e.g., Audit Reports Nos. 1-517-86-17-Peru, 1-519-86-7 El Salvador, 1-518-86-8 Ecuador.

Management Comments

USAID/Costa Rica, in its written response to the draft audit report, stated that it has issued Project Implementation Letters (PILs) to improve the language used in Section 8.4, "Rate of Exchange," of its currently active loans 032, 034, and 041. The Mission stated that copies of those PILs had been forwarded to our office. However, we have not yet received same. When we do, we will move to close Recommendation No. 1.

Management of Cash Advances Needed Improvement - USAID/Costa Rica had outstanding cash advances of \$5,222,990 to Government of Costa Rica implementing agencies under five loan projects as of January 31, 1986:

Project 0145 (Loan 032)	-	\$ 727,005.91	
Project 0148 (Loan 034)	-	677,805.02	
Project 0176 (Loan 035)	-	2,211,983.39	
Project 0187 (Loan 038)	-	1,537,900.00	
Project 0191 (Loan 041)	-	<u>68,295.92</u>	
	TOTAL		\$5,222,990.24 =====

AID Handbook 19, Appendix 1B, Section B3.d. (2) states that advances may be provided for thirty days' cash requirements unless the Bureau Assistant Administrator, Mission Director, or Office Head has determined in writing that implementation would be seriously interrupted or impeded by applying the thirty-day rule, in which case advances may be extended for as long as ninety days. While USAID/Costa Rica's procedure was to provide cash advances on a project-by-project basis for periods of as much as 90 days based on anticipated requirements submitted by implementing agencies, no written policy determination waiving the 30-day rule existed.

The Mission controller cited a document titled "Payment Provisions" as his basis for providing cash advances for more than 30-days' requirements. That document, which was neither dated nor signed, stated that an initial advance outlay (not to exceed 90-days' cash needs) may be made by A.I.D. to the recipient. Another source cited to support the Mission's procedure was an October 5, 1983 cable from USAID/Costa Rica to Washington which stated that the controller's office had devised new procedures for periodic advances for all new implementation activities. However, neither of those documents contained a determination that project implementation would be seriously interrupted or impeded by applying the 30-day rule.

USAID/Costa Rica's cash advance procedures had, in some cases, allowed cash advances under certain active loans to exceed cash advances approved by specific project implementation letters. Also, cash advance balances, in some cases, were excessive when compared with the recipients' actual expenditures. Therefore, we concluded that in certain cases implementing agencies had on hand AID-provided cash balances in excess of their requirements. This cost the U.S. Government additional interest to borrow those funds.

Implementation letters approved cash advances of 30 days for certain projects. But USAID/Costa Rica provided cash advances for periods of as much as 90 days to some of those same projects. For example:

- Project No. 515-0148 (Loan 515-T-034) Agrarian Settlement Project -- Project implementation letters No. 12, dated November 20, 1981, and No. 34, dated March 9, 1984, provided for advances to cover the financial needs of the project's general fund for a 30-day period. However, USAID/Costa Rica had provided cash advances to the project's general fund for cash requirements of from 60 to 90 days as budgeted by the implementation agency.
- Project No. 515-0145 (Loan 515-T-032) Natural Resources Conservation Project -- Implementation letters approved advances to cover anticipated expenditures for a 30-day period. USAID/Costa Rica provided cash advances based on 60-to-90 days' cash requirements, as budgeted by the implementing agency.

Excess advances for some projects had increased the U.S. Treasury's cost of borrowing funds to support Government programs. For example:

- Project No. 515-0145 (Loan 515-T-032) Natural Resources Conservation -- This project had a September 13, 1985 planned completion date. The Mission controller's project liquidation records showed an outstanding cash advance balance of \$727,006 on January 31, 1986 of which \$705,312 was in a fund of the National Bank of Costa Rica (account No. 3200-05 No. 178). Exhibit I shows a chronological history of excess cash advance balances in that fund from July 26, 1984 to January 31, 1986. The \$705,312 balance had not been reduced as of March 1986. According to the controller, sufficient unprocessed liquidation vouchers had been subsequently submitted to substantially liquidate the balance. Those vouchers had apparently not been processed due to problems with some of the claimed expenditures. Using the U.S. Treasury's cost of funds for the period August 1984 through January 1986, we computed that the increased cost of borrowing funds in excess of 90-days' cash needs for this fund had been approximately \$67,000. (See Exhibit I).
- Project No. 515-0187 (Loan 515-T-038) Private Sector Export Credit -- A cash advance of \$1,537,900 was granted on December 4, 1985 for cash requirements for November and December 1985. However, as of March 10, 1986, only \$545,000 in liquidation vouchers had been processed resulting in an outstanding cash advance balance of \$992,900. Using the U.S. Treasury's cost of funds for the period December through January 1986, we computed that the increased cost of borrowing funds in excess of 90-days' cash needs for this fund had been approximately \$12,000. (See Exhibit II).

Using an estimated seven percent future cost-of-funds rate, we computed that the U.S. Government's increased cost of borrowing funds over the next 12-month period would be approximately \$107,036 for the two examples cited above.

## Recommendation No. 2

We recommend that USAID/Costa Rica:

- a) review its portfolio of cash advances and, if appropriate, make a formal determination that providing cash advances for only 30 days' requirements would seriously interrupt or impede project implementation before making any further cash advances for more than 30-day requirements.
- b) review all currently outstanding cash advances and adjust their amounts to conform to actual cash needs, based on expenditures of the implementing agencies and the Mission's policy determination requested above.

## Management Comments

USAID/Costa Rica acknowledged that it had not made a formal determination that providing cash advances for only 30-days' requirements would seriously interrupt or impede project implementation. Management stated that its current system was designed to authorize initial 90-day cash advances with subsequent advances not permitted in excess of 30-days needs. They stated the system recognized that up to 50 working days were required for voucher processing. Management further stated that it had been conservative in its cash management practices and considers the advance system currently being used adequate with no further action necessary.

USAID/Costa Rica stated that they had evaluated their outstanding cash advances and, except for project 091 (Loan 041), found no other outstanding advances for more than the approved 30-day limitation. They stated that \$45,886 of the outstanding advance of \$51,009 for loan 041 was found to be in excess of the borrower's 30-day requirements. Management had taken action which they felt will liquidate the excess advance by June 30, 1986.

Management did not agree that it had maintained advances in excess of 90-days' needs for project 0145 (Loan 032). They stated that a trust fund agreement between the Costa Rica Ministry of Agriculture and Livestock (MAG) and the National Bank of Costa Rica (BNCR) established a 100,000,000 colones trust fund on June 12, 1984 in the BNCR. Management feels that disbursements from the AID loan to the trust fund could have been considered valid project expenditures when the advances were made. They stated that had AID not advanced the loan funds, the borrower would have had to use its limited funds to finance the sub-borrowers.

## Office of Inspector General Comments

We acknowledge USAID/Costa Rica's determination to closely monitor all outstanding advances and take corrective actions when necessary. However, the fact remains that its advance system permitted cash advances for more than 30-days' needs, and that such advances had in fact occurred as stated in the audit report. Therefore, we have retained part (a) of

Recommendation No. 2 until such time as USAID/Costa Rica makes a formal determination that making cash advances for only 30-days' requirements would seriously interrupt or impede project implementation.

USAID/Costa Rica has reviewed all of its currently outstanding cash advances and has determined that only project 0191 (Loan 041) currently has cash advances in excess of 30-days' requirements. We will accept management's assessment of its current outstanding advances upon submission of voucher evidence. However, we cannot accept management's conclusion that advances under project 0145 (Loan 032) to finance a trust fund could have been considered valid project expenditures when the advances were made. Vouchers show that the \$720,000 advance made on July 26, 1984 was for the three-month period of July 1, 1984 through September 30, 1984, and that the \$1,080,090 advance made on May 3, 1985 was for the period May 1, 1986 through June 30, 1986. Evidence shows that expenditures were not as anticipated for either advance, and therefore, the amounts of the advances should have been adjusted. A recent cable from AID's Office of Financial Management (State 140362 dated May 1986) further reinforces the policy that advances are only for immediate project cash needs and an advance to an intermediate credit institution is not to be considered an expenditure as implied by USAID/Costa Rica.

Personal Services Contracting (PSC) and Non-PSC Contracting Procedures For U.S. Citizens Needed Improvement - Many of the PSC and non-PSC files reviewed did not include required documentation: of nine PSC files reviewed, seven had no medical clearances, three had no Standard Forms 171 - Personal Qualifications Statement, two had no security clearances, and one had no memorandum of contract negotiation. Of the five non-PSC files reviewed, five had no medical clearances, four had no security clearances, two had neither Standard Forms 171 nor Biographical Data Sheets (Form AID 1420-17), and two had no memoranda of negotiation. Agency regulations on contracting for services have sometimes been vague and fragmented, especially as to what documents must be maintained in a contractor's files. Nevertheless, it seems apparent that at least the above noted documents should be in every contractor's file regardless of where the contract was executed. (Some of the contracts were executed in Washington, D. C.). Otherwise, the Mission, which has the responsibility for executing projects and protecting AID resources, does not possess adequate assurance that the contractor has proper qualifications and clearances.

In fact, subsequent to our review the Agency issued new Handbook guidance for contracting for the personal services of U.S. citizens and U.S. resident aliens abroad. The new guidance (Appendix D to AID Handbook 14) requires, among other things, that completed security clearances, medical clearances, Standard Forms 171 - Personal Qualification Statement and Memoranda of negotiation be included in contract files before the contract is signed by both parties.

We also noted that the Mission had funded the services of a program assistant through a purchase order in the amount of \$8,250 from October 1985 through May 27, 1986. This arrangement persisted even though a Project Implementation Order for Technical Services reserving funds for her services had apparently been approved in December 1985. The

individual was assigned to the Mission's Justice Office. Purchase orders are not a normal mechanism for contracting for personal services and should not be used as they tend to circumvent such procedures as advertising for the vacant position and withholding Federal Income and FICA taxes.

### Recommendation No. 3

We recommend that USAID/Costa Rica:

- a) document each contractor's file, as applicable, with (i) Standard Forms 171 - Personal Qualifications Statement, (ii) security clearances, (iii) evidence of medical clearances and, (iv) memoranda of negotiation;
- b) advertize the program assistant position in its Justice Office as a personal services contract vacancy in accordance with normal Agency procedures.

### Management Comments

USAID/Costa Rica stated that it had reviewed its contract files and had either requested or obtained the documentation required. The USAID also stated that it had requested the Commerce Business Daily to advertize for the services of a program assistant for its Regional Administration of Justice Project Office.

Based on the USAID's reported actions, part (b) of Recommendation No. 3 is closed upon issuance of this report. Part (a) can be closed when the USAID has actually obtained the requested and necessary documentation for the contractor's files and so advises us.

Please provide this office written advice of any additional information related to actions planned or taken to implement the three recommendations in this report within 30 days.

**AUDIT OF USAID/COSTA RICA'S  
MANAGEMENT OF SELECTED  
MISSION ACTIVITIES**

**EXHIBITS AND APPENDICES**

EXHIBIT I

COMPUTATION OF INCREASED COST OF BORROWING FUNDS  
IN EXCESS OF 90 DAYS NEEDS. - PROJECT NO. 515-0145 (LOAN 515-T-032)

		<u>Cost of <math>\frac{1}{}</math> Funds Rate</u>	<u>No. of Months</u>	<u>Excess Cost of Funds</u>
- Advance Disbursement 7/26/84	\$720,000			\$
- Liquidation 10/19/84 (July- Sept. '84 expenditures)	<u>(70,483)</u>			
- Advances in excess of 90- days' needs (Aug-Sept 1984)	649,517	x 9.84%	x 2/12 =	10,652
- Liquidation 2/20/85 (Oct- Dec. '84 expenditures)	<u>(305,716)</u>			
- Advances in excess of 90- days' needs (Oct-Dec 1984)	343,801	x 10.38%	x 3/12 =	8,922
- Liquidation 5/3/85 (Jan- March '85 expenditures)	<u>(155,082)</u>			
- Advances in excess of 90- days' needs (Jan-April 1985)	188,719	x 9.16%	x 4/12 =	5,762
- Advance Disbursement 5/3/85 Balance	<u>1,080,090</u> <u>1,268,809</u>			
- Liquidation 8/22/85	(427,376)			
- Liquidation 9/9/85 (April- June '85 expenditures)	<u>( 27,165)</u>			
- Advances in excess of 90- days' needs (May-June 1985)	814,268	x 8.01%	x 2/12 =	10,870
- Liquidation 12/9/85 (July- Oct '85 expenditures)	<u>(108,956)</u>			
- Advances in excess of 90- days' needs (July-Oct 1985)	705,312	x 7.70%	x 4/12 =	18,103
- No additional liquidations through January 1986 (Nov '85 -Jan '86)	<u>-0-</u>			
- Advances in excess of 90-days' needs (Nov 1985-Jan 1986)	705,312	x 7.28%	x 3/12 =	<u>12,837</u>
TOTAL.				<u>\$67,146</u> .....

1/ Average 90-day Treasury Bill rate for period covered.

EXHIBIT II

COMPUTATION OF INCREASED COST OF BORROWING FUNDS  
IN EXCESS OF 90 DAYS NEEDS. - PROJECT NO. 515-0187 (LOAN 515-T-038)

		<u>Cost of 1/ Funds Rate</u>	<u>No. of Months</u>	<u>Excess Cost of Funds</u>
- Advance Disbursement 12/04/85	\$1,537,900	\$		\$
- Liquidation 03/10/86	<u>(545,000)</u>			
- Advances in excess of 90-days' needs (Dec. 1985 -Jan. 1986)	\$ 992,900	x 7.28%	x 2/12 =	\$ 12,047 *****

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1/ Average 90-day Treasury Bill rate for period covered.

LIST OF RECOMMENDATIONS

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<u>Recommendation No. 1</u>	5
<p>We recommend that USAID/Costa Rica take appropriate steps to conform Section 8.4 (Rate of Exchange) of its current and future loan agreements with the standard language in AID Handbook 3, Appendix 6 A-1, page 12.</p>	
<u>Recommendation No. 2</u>	8
<p>We recommend that USAID/Costa Rica:</p> <ul style="list-style-type: none"><li>a) review its portfolio of cash advances and, if appropriate, make a formal determination that providing cash advances for only 30 days' requirements would seriously interrupt or impede project implementation before making any further cash advances for more than 30-day requirements.</li><li>b) review all currently outstanding cash advances and adjust their amounts to conform to actual cash needs, based on expenditures of the implementing agencies and the Mission's policy determination requested above.</li></ul>	
<u>Recommendation No. 3</u>	10
<p>We recommend that USAID/Costa Rica:</p> <ul style="list-style-type: none"><li>a) document each contractor's file, as applicable, with (i) Standard Forms 171 - Personal Qualifications Statement, (ii) security clearances, (iii) evidence of medical clearances and, (iv) memoranda of negotiation;</li><li>b) advertize the program assistant position in its Justice Office as a personal services contract vacancy in accordance with normal Agency procedures.</li></ul>	

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