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**AUDIT OF
INVESTMENT COUNCIL OF PANAMA
PROJECT NO. 525-0239**

**Audit Report No. 1-525-86-27
August 29, 1986**

AGENCY FOR INTERNATIONAL DEVELOPMENT

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August 29, 1986

MEMORANDUM FOR: D/USAID/Panama, Ronald D. Levin

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

Coinage N. Gothard

SUBJECT : Audit of Investment Council of Panama, Project No. 525-0239, Report No. 1-525-86-27

This report presents the results of audit of the Investment Council of Panama. Please advise us within 30 days of any additional information relating to actions planned or taken to implement the recommendations. We appreciate the cooperation and courtesy extended our staff during the audit.

Background

In response to increasing economic and unemployment problems, the Government of Panama (GOP) established the Investment Council of Panama (ICP) in August 1982 to help promote domestic and foreign investment. In July 1983, USAID/Panama and the GOP signed a $12.1 million Project Agreement (No. 525-0239) to develop the Council's capacity to promote and service new export-oriented investment. Project funding consisted of $4.0 million in USAID/Panama loan ($3.8 million) and grant ($200,000) funds and $8.1 million in GOP counterpart funds. As of June 27, 1986 USAID/Panama had disbursed $823,000 in loan and $131,000 in grant funds; approximately $5 million in GOP funds had been disbursed. The project assistance completion date is August 31, 1987.

Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a program results and financial/compliance audit of the Investment Council of Panama project during the period May 5, 1986 to June 27, 1986. The project was selected for audit because of its private sector focus and the delays experienced in its implementation. The audit covered $954,000 in AID project disbursements from September 1983 to April 1986.

The audit was supplemented by findings reported in an April 30, 1986 Price Waterhouse and Company evaluation report commissioned by USAID/Panama. This comprehensive report was critical of both USAID/Panama's and the ICP's management of the project. Both USAID/Panama and Council officials concurred with the evaluation's findings and recommendations. To avoid duplication of the recent evaluation report, the scope of our audit was limited to determining (1) the extent of the project's accomplishments, (2) whether USAID/Panama had complied with AID financial regulations, and (3) the adequacy of internal controls. Audit work included reviewing project files, records and other pertinent data, and interviewing officials at USAID/Panama and at the Investment Council of Panama. The audit was made in accordance with generally accepted government auditing standards.

Results of Audit

The project had not achieved, nor is it likely to achieve, its intended results during its remaining year because USAID/Panama had not required strict adherence to provisions contained in project design and agreement documents. Falling behind in achieving planned targets meant the project would have more funds available than it could effectively use during its last year of operations. However, USAID/Panama had not adhered to AID financial regulations requiring that excess obligations be deobligated. Furthermore, project advances had remained outstanding longer than allowed by AID regulations. USAID/Panama had exercised adequate internal controls over the receipt and disbursement of project funds.

According to the Price Waterhouse evaluation report, the project had benefited Panama to the extent that it had attracted some new investments and created new jobs which might not otherwise have been accomplished.

The audit showed that USAID/Panama had not (1) required the ICP to comply with the provisions of the project design and project agreement, (2) taken action to reduce excess project obligations, and (3) taken steps to reduce the amount of outstanding project advances.

The report recommends that USAID/Panama (1) bring the project into compliance with the project's original provisions by requiring the Council to agree to specified activities during the project's remaining year, (2) deobligate and/or reprogram excess project obligations, and (3) require the Council to liquidate outstanding advances.

1. The Investment Council of Panama Project Had Fallen Short of Its Planned Objectives - The project paper established goals to attract $68 million in new investments in export-oriented industries, and to create 8,500 jobs over the life of the project. According to the Price Waterhouse report, the project had succeeded in attracting only $21 million in new investments and in creating only 1,890 new jobs because of non-compliance with provisions in the project design and project agreement. With one year remaining, it was unlikely the project would be able to attract an additional $47 million in new investments or create 6,600 new jobs.

Discussion - At the project's outset, USAID/Panama officials recognized that ICP's staff was inexperienced in promotional activities, that its management controls were untested and that markets were not yet fully developed. To compensate for these shortcomings the project design included provisions for the Council to contract with a senior development advisor, to provide on-the-job training to the entire management team and to furnish more specialized technical assistance to its research and development staff. In addition, the project design recognized that studies would have to be performed to identify geographical areas warranting ICP promotional activities, and to identify the products that could benefit from applying Panamanian materials and labor. However, these key project studies were not accomplished by the Council.

In the evaluation report, the Price Waterhouse evaluators stated that the Council's performance was "...unsatisfactory overall and is currently far from meeting the project purpose and targets...". The report attributed the project's low level of achievement to USAID/Panama's and GOP's not implementing the project in accordance with the provisions of the project design and project agreement. The evaluation report cited several key project design elements which the Council had not accomplished. These included: (1) not establishing a viable organization with a stable professional management team; (2) failing to perform product marketing studies, considered essential to targeting promising investment areas and guiding investment promotion activities; and (3) not acquiring experienced technical assistance. The report also criticized USAID/Panama for not closely monitoring the project and for allowing it to stray from its original design. The evaluation report recommended that the project be scaled down and that, during the project's remaining year, emphasis be placed on performing market and product studies and acquiring technical assistance. USAID/Panama agreed with the evaluation's recommendations.

AID regulations provide that when a borrower/grantee fails to fulfill its responsibilities under a project agreement, AID management should take actions to resolve the ensuing problems, which may include invoking the terms of the agreement when the implementing agency fails to satisfactorily correct the situation. USAID/Panama management, through its project monitoring activities and quarterly report system, was aware that ICP had not contracted out for necessary technical assistance nor performed required studies. However, the Mission did not take firm action to resolve these deficiencies. USAID/Panama encouraged the Council to implement the project design provisions, but it did not require ICP to comply with them. This "soft" approach was not successful, in part, because of the lack of management continuity at the Council due to frequent changes in Panama's political environment. For example, in the four-year history of the project, there had been four Presidents of Panama, and in turn, four ICP Executive Directors. USAID/Panama management had to contend with each of these changes in moving the project towards its stated objectives.

At the end of the audit, USAID/Panama was attempting to obtain a renewed commitment to the project's objectives from the GOP. An action plan with specific activities for the Council to accomplish during the project's remaining year was developed. The first was for the GOP to provide USAID/Panama with a written reaffirmation of its commitment to the project. The overall objective of USAID/Panama's action plan was to align the project with the terms of the original project paper and agreement. However, since January 1986 the project had been "put on hold." Proposed ICP 1986 work and financial plans had not been approved by USAID/Panama because they were not consistent with Price Waterhouse report recommendations. As a result, AID had not funded the project for the past seven months. If a commitment is not obtained soon, it will be difficult for the project to meet its objectives.

Recommendation No. 1

We recommend that USAID/Panama obtain, by July 31, 1986, the Government of Panama's agreement with a project implementation letter confirming the action plan during the project's remaining year. If this agreement cannot be obtained by then, the project should be terminated.

On July 10, 1986, USAID/Panama and the GOP signed a project implementation letter detailing the actions to be taken during the project's remaining year. Based on this action, recommendation No. 1 was closed upon issuance of the report.

2. Excess Project Funds Were Available - The project had not fully funded many of its key design elements including procuring the services of a senior development advisor, providing staff training, procuring technical assistance, performing market and product studies, and procuring a computer and related software. Only about one-fourth of USAID/Panama's obligations had been used, leaving $3 million in the project's "pipeline" 1/ as of March 31, 1986, with only one year remaining in the project. AID regulations require that excess obligations be deobligated and/or reprogrammed. USAID/Panama had not taken any action to reduce project obligations; therefore, these funds were unavailable for use in other possibly higher priority projects.

Discussion - In August 1983, USAID/Panama fully obligated the project's funds of $3,973,000 ($3,773,000 in loans and $200,000 in grants). As of March 31, 1986 only about $954,000 ($823,000 loan and $131,000 grant) had been disbursed, leaving over $3 million in the pipeline, or about 75 percent of the funds obligated since 1983. Over $2 million of the pipeline had not even been earmarked for specific project purposes during the past three years. The Price Waterhouse evaluation report and USAID/Panama management attributed the excess fund situation to ICP management decisions not to finance many of the project's elements on the basis that they were too costly and/or were not needed.

AID Handbook 3, Section 13D8 states that whenever it is certain that funds authorized and obligated for the life of the project exceed the amount actually required, steps should be taken to deobligate the excess amount. USAID/Panama had not taken steps to deobligate excess project obligations on the basis that they might be needed by the project in the future. As a result, these monies were unavailable for use in other possibly higher priority projects.

1/ The "pipeline" amount represents the difference between project obligations and accrued and actual project expenditures.

As discussed earlier, USAID/Panama was attempting to put together an action plan to implement as many of the originally designed activities as possible during the project's last year. However, since approximately $4 million had been planned to be expended over the four-year life of the project, it was not likely that ICP would have the capacity to effectively absorb over $3 million during its last year. USAID/Panama officials stated that they were reluctant to deobligate funds now because the funds may be needed if a decision is made to extend the project life. However, based on the project's past performance, the lack of GOP commitment to the project, and the likelihood the project will not achieve its revised objectives, there does not appear to be a strong basis for continuing the project beyond its original planned completion date.

Recommendation No. 2

We recommend that USAID/Panama determine the amount of obligated funds required to complete the activities proposed during the project's remaining year, and deobligate and/or reprogram the remainder.

USAID/Panama determined that approximately $2.4 million in AID obligated funds were required to complete planned activities during the project's remaining year, leaving $639,000 unearmarked. The Mission decided to defer a decision on deobligating the remaining funds, however, until such time the Mission can evaluate the progress of the activities planned during the remaining year. Based on these actions, recommendation No. 2 remains open until such time as the Mission deobligates and/or reprograms the currently unrequired amount, or until such time as the Mission can provide evidence that the funds can be effectively and efficiently used under the project.

3. Excess Outstanding Advances Have Resulted from Implementation Problems - The project was advanced AID funds towards the performance of technical assistance and promotional and marketing activities. As of June 21, 1986 the Council had $150,000 in such advances, which had been outstanding since March 1986, in excess of AID time requirements. The large advance amount was caused by a suspension of AID-financed activities. The last advance draw-downs occurred in January and February 1986, when the Mission processed Council vouchers for 1985 expenditures totaling approximately $66,000. As a result of the outstanding advances, the U.S. Government was incurring unnecessary interest costs of $750 each month.

Discussion - Advances held by the implementing agency in excess of 30 days' requirements violate the provisions of AID Handbook 1, Supplement B, Page 15-8, Section (c) which state that advances should be based on an analysis of cash requirements and limited to the minimum amount needed for immediate disbursing needs up to 30 days.

The large advance balance was caused by a suspension of AID financed activities. USAID/Panama was prohibited by the project agreement from funding project activities which were not identified in approved project annual work and financial plans. The last ICP work and financial plans approved by USAID/Panama were for 1985. The 1986 work and financial plans had not been approved at the time of our audit and, according to Mission officials, would not be approved until the Mission and the Council came to an agreement on ICP activities for the remaining project life.

Because of this impasse, $150,000 in outstanding advances had not been authorized for use for four months and would not be authorized for use until the Mission and the Council sign a Project Implementation Letter reconfirming their commitment to the project. In the meantime, the U.S. Government had incurred about $3,000 in unnecessary interest cost and continues to incur an interest cost of $750 each month the advance remains unliquidated.

Recommendation No. 3

We recommend that USAID/Panama require the Council to liquidate the outstanding advance balance through authorized expense vouchers and/or repayment until future project plans and budgets have been formally agreed to by all involved parties.

As a result of the agreement reached between USAID/Panama and the GOP on the activities planned during the remaining year, the Mission was again processing vouchers against advances to the Council. Based on this action, recommendation No. 3 was closed upon issuance of the report.

UNITED STATES GOVERNMENT
memorandum

DATE: August 22, 1986

REPLY TO ATTN OF: Denton E. Larson, Controller, USAID/Panama

SUBJECT: Draft Audit Report, Investment Council of Panama
Project No. 525-0239

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

Attached is a memorandum from the Chief of the Office of Private Sector Development (OPSD) reporting on actions taken to implement the three recommendations contained in subject draft audit report. Based on these actions, we request that recommendation Nos. 1 and 3 be closed.

Also, you may wish to consider deleting or modifying recommendation No. 3. Although the advance recorded in the accounting records was $150,000, the actual cash on hand was considerably less. The vouchers received represented disbursements by the ICP during January to June 1986 for approved activities included in the CY 1985 financial plan. In retrospect we agree that the amount of funds exceeded the AID policy on advances. However, it was not practical to recover the advance as the project had not been formally suspended and projections available indicated that the amount of the advance was not excessive. The projection of cash needs is not an exact science and judgments must be made between providing an advance which may exceed the guidelines or running the risk of the project having inadequate cash resources which may impede project activities.

Attachment: a/s

<u>Inspector General Comments</u>

USAID/Panama submitted copies of project implementation letters No. 13, 14, 15 and 16 which were considered in finalizing the report; however, they have not been included herewith.

UNITED STATES GOVERNMENT

memorandum

DATE: August 21, 1986

REPLY TO ATTN OF: Frank Skowronski, Chief OPSD

SUBJECT: Draft Audit Report, Investment Council of Panama, Project No. 525-0239-Comments

TO: Mr. Denton Larson, CONT.

Recommendation No. 1

Agreement was reached at a June 14, 1986, meeting of USAID and GOP representatives to place to ICP project under review for a period of one year during which time a series of remedial actions will be carried out. The review year will end on Auguest 31, 1987.

This agreement was confirmed in Project Implementation Letter (PIL) No. 13, dated July 10, 1986. The action plan that is mentioned in the Draft Audit Report was incorporated into the PIL as Annex A, Schedule of Activities.

Thus, Recommendation No. 1 was closed as of July 10, 1986.

Recommendation No. 2

Following the agreement confirmed by PIL No. 13, ICP submitted to USAID Work Plans and a Financial Plan for the review period which will end August 31, 1987.

USAID approval of the Financial Plan was given in PIL No. 14.

The Financial Plan determines that obligated funds required to end of project are estimated as follows:

In 000's	ProAg Amendments	Financial Plan	Total Project	Estimate Remaining
AID Loan	3,772	2,381	3,133	639
AID Grant	200	48	200	—
GOP	8,110	1,806	6,789	—

Recommendation No. 2 has been partially closed in that the amount of obligated funds required to complete the activities proposed during the remaining year has been determined.

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The amount estimated to be left at the end of the project is $639,000.

Now that the Financial Plan has been accepted, the Board of Directors is in place and functioning and the contracting of technical assistance is well under way, there is reason to believe that implementation will proceed according to plan through the remaining months of the project. This would, of course, result in a reorganized, revitalized ICP with a qualified management team, with substantial capability in planning, executing, coordinating and reporting an Investment Promotion Program.

Assuming the achievement of this result, ICP at the end of the project will be on the verge of realizing significant results in terms of investments attracted and jobs created.

Based on actions already taken and planned USAID/Panama believes that it is prudent to defer a decision on deobligation of funds at this time. USAID/Panama will review the schedule of activities as agreed in PIL 13 and make a decision as to continuation of the project beyond the current PACD of 8/31/87. This decision will be made by 2/10/87. At that time we will also be in a better position to determine the amount of funds needed to complete the project.

Recommendation No. 3

USAID is now processing about $94,000 in ICP vouchers. These will be processed as liquidation vouchers, reducing the advance to about $56,000. PIL No. 16 advises ICP regarding the processing of their vouchers.

The $56,000 advance remaining is being utilized to initiate activities authorized under PIL No. 13.

Attachments:
PIL Nos. 13, 14, 15 & 16

APPENDIX B

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