PD-AAV-096
(AN 45281

5150176
5150187
5150204

AUDIT OF
USAID/COSTA RICA'S
PROJECT MONITORING SYSTEMS

Audit Report No. 1-515-87-21
March 17, 1987

AGENCY FOR INTERNATIONAL DEVELOPMENT

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

OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA — HONDURAS

TELEPHONES:
32-0044 & 32-0092
also 32-3120/9, EXT. 293 & 296

March 17, 1986

MEMORANDUM FOR: USAID/Costa Rica, Director, Daniel Chaij

Coinage N. Gothard

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

SUBJECT : Audit of USAID/Costa Rica's Project Monitoring Systems

This report presents the results of audit of USAID/Costa Rica's Developmental Assistance Project Monitoring Systems. Mission comments have been considered in preparation of this report and are included in full as Appendix 1. Please advise us within 30 days of any additional information relating to actions planned or taken to implement the recommendation. We appreciate the cooperation and courtesy extended to our staff during the audit.

Background

AID Handbook 3, Chapter 11, Section E states that Bureaus or Missions need to establish project monitoring and portfolio oversight systems to monitor borrower/grantee compliance with AID policies, procedures, and regulations. AID Handbook 3, Chapter 12 provides detailed guidance for project evaluation officers. Two activities integral to project monitoring are: tracking and implementing recommendations contained in project evaluations; and establishing systems to ensure compliance with all special covenants, conditions precedent to disbursement, and other loan and grant requirements.

Within USAID/Costa Rica, the Mission's evaluation officer is located in the Program Office and is responsible for oversight of the project evaluation process. The Mission's Project Development Division is responsible for the maintenance of "official project files" and oversight of borrower/grantee compliance with special covenants, conditions precedent to disbursement, and other grant and loan requirements. The responsibility for ensuring that the borrower/grantee complies with loan agreement requirements resides with the project officers.

Audit Objectives and Scope

As part of the scheduled audit of three intermediate credit institution projects (ICIs) being implemented by the Mission's Private Sector Office, a limited-scope compliance audit was made of the Mission's project monitoring systems. The review covered the period September 25, 1981 to November 13, 1986. The specific objectives of this review were to: (1) determine if the Mission had an adequate tracking system to ensure that project evaluation recommendations were promptly acted on and implemented, and (2) verify if the Mission had an adequate project monitoring system that would ensure compliance with special covenants, conditions precedent to disbursement, and other loan and grant agreement requirements.

Seven Mission project evaluation reports were reviewed as well as the official project files for the three ICI projects: Private Sector Productivity Project No. 515-0176, managed by the Agricultural Industrial Export Bank (BANEX); Private Sector Export Credit Project No. 515-0187, Industrial Finance Corporation of Costa Rica (COFISA); and Private Investment Corporation Project No. 515-0204, Private Investment Corporation (PIC). These reviews were undertaken between September and November 1986 within USAID/Costa Rica's Program Office, Project Development Division, and Private Sector Office. We interviewed five Mission officers and reviewed the Mission's operational directives and files. Administrative internal controls were examined as they related to project monitoring and evaluations. This audit was made in accordance with generally accepted government auditing standards.

Results of Audit

The review showed that USAID/Costa Rica did not have an adequate developmental assistance tracking system to ensure that project evaluation recommendations were promptly acted on and implemented. Also, we determined that the Mission did not have an adequate developmental assistance project monitoring system to ensure compliance with special covenants, conditions precedent to disbursement, and other loan and grant agreement requirements.

Although the Mission lacked a developmental assistance project monitoring system, the Mission did possess an automated system to track 99 special covenants under its Economic Stabilization Recovery (ESR) Program. This system was established because the Mission had found that it was unable to adequately track and monitor the status of special covenants on this program without such a mechanism. The requirements of developmental assistance are somewhat different than those of ESR Program.

With the above exception (of an ESR tracking system), USAID/Costa Rica had not established the systems needed to ensure the timely and effective implementation of recommendations made in developmental assistance evaluation reports and to monitor compliance with developmental assistance special covenants, conditions precedent to disbursement, and other requirements. We are recommending that USAID/Costa Rica establish procedures to ensure the timely preparation of project evaluation summaries and the tracking of related recommendations, and to establish a developmental assistance project tracking system to monitor compliance with special covenants, conditions precedent to disbursement, and other project requirements for all projects.

1. <u>USAID/Costa Rica did not ensure timely and effective implementation of evaluation report recommendations as required by AID Handbook 3, Chapter 11</u> - USAID/Costa Rica gave first priority to getting projects started with the idea that control systems would naturally follow later. As a result, recommendations contained in project evaluation reports may not have been promptly implemented, thus diminishing or negating their presumed benefits for successful project implementation.

Discussion - AID Handbook 3, Chapter 12 requires AID Missions to appoint an Evaluation Officer who is responsible for management of the evaluation system. Duties of Evaluation Officers are defined within Mission evaluation systems. These evaluation officers assist Project Officers in planning and conducting evaluations and reporting evaluation findings and decisions. Actions critical to an effective project evaluation are preparing a record of evaluation findings and recommendations and implementation of the recommendations.

AID Handbook 3, Chapter 12, Appendix 12A-1 cites the prescribed form for completing the Project Evaluation Summary (PES), Parts I and II. Part I of the PES (face sheet) requires that all decisions and/or unresolved issues be listed along with the name of the officer responsible for the action and the date for the planned completion of the action. Part II of the PES requires the Mission to summarize its views on the various topics covered by the evaluation.

USAID/Costa Rica had not established the required systems to ensure timely and effective implementation of recommendations made in evaluation reports as required by AID Handbook 3, Chapter 11.

First, PES face sheets had not been prepared in a timely manner. This should be completed within 30 days after receipt of the final evaluation report (similar to response times for IG draft reports). The face sheets contain the recommendations to be implemented from the evaluation, the office responsible for implementing the recommendation and the date by which the recommendation should be implemented. As of October 28, 1986 seven evaluations had been completed, but PES face sheets had not been prepared for six of them. At least three of these evaluations had been available to the Mission for more than a month.

It could not be determined how long the other three evaluations had been in the Mission as they had not been logged in by the Program Office or the project offices. The auditors were told that the Program Office lacked control procedures to ensure receipt of all evaluations and, in fact, many were not sent to that office, but rather directly to the various project offices.

Second, a system had not been established to track the recommendations contained on PES face sheets to ensure their effective implementation by assigned offices within established time frames. For example, the BANEX interim project evaluation (first evaluation) was received by USAID/Costa Rica in June 1983 but the PES face sheet was not prepared until December 28, 1983. At least one of the actions on the face sheet was not accomplished by the date planned. The escrow account for the risk minimization fund was not established until April 12, 1984, over three months later than planned on the face sheet. Documentation was not available to show when the other recommendations were actually accomplished. A PES tracking system would have documented which actions had been completed and which were still open. The PES face sheet indicated only planned dates of implementation, and not the actual dates as would a tracking system.

The primary cause of the delays noted in preparing PES face sheets and for the nonexistance of a Mission tracking system for evaluation recommendations was the low priority given to this by previous management, as shown by the absence of operational directives on these subjects. The Mission indicated they gave first priority to getting projects started with the idea that control systems would naturally follow later. As a result of the above, the Mission did not have adequate assurance that projects had received the benefits of prompt implementation of recommendations made in evaluation reports or that the considerable cost of these evaluations to AID had been well spent.

2. <u>USAID/Costa Rica had not ensured compliance with all developmental assistance special covenants, conditions precedent to disbursement, and other loan and grant requirements</u> - AID Handbook 3, Chapter 11 indicates that Missions need to establish project monitoring systems to ensure compliance. USAID/Costa Rica gave first priority to getting projects started with the idea that control systems would follow later. As a result, we found numerous examples where special covenants, conditions precedent to disbursement, and other AID requirements were not met while disbursements continued to be made, thus limiting the chances for successful project implementation.

Discussion - AID Handbook 3, Chapter 11, Section E states:

> Because of the wide variety of Bureau Programs and Projects, an Agencywide reporting and monitoring requirement...has not been established. It is left up to individual Bureaus and Missions to establish project monitoring and portfolio oversight systems....At the least,...systems must have monitoring procedures or methods to oversee Borrower/Grantee compliance with AID policies, procedures, and regulations; ensure the timely and coordinated provision of AID...financing and/or inputs; support the Borrower/Grantees' efforts re the effective utilization of resources and accurate forecasting of future problems; identify implementation issues and projects not performing satisfactorily; collect data and information for subsequent AID project analyses and develop an historical record of implementation for the official AID project files; and prepare periodic reports for Mission and AID Washington review.

Several examples taken from our audits of three private sector banking projects illustrate the effects of not having such a monitoring system in place. These examples show that project requirements were either not complied with or were not fulfilled within specified time frames. The recommendations to correct the compliance deficiencies listed below were covered in our audit reports on the aforementioned three private sector projects.

-- For almost 24 months, BANEX did not enter into an escrow agreement or open an escrow account for the risk minimization fund as required by condition precedent to initial disbursement 5.1(j) of loan agreement 515-0176; as a result, when loan monies were disbursed the required three percent set aside for the risk minimization fund was not deposited and AID was left uninsured, which, in the absence of a GOCR loan guaranty, left the Agency exposed to greater risk.

-- For 14 months, BANEX did not comply with the debt-to-equity ratio requirements established in special covenant 6.1(y) of loan agreement 515-0176; as a result, the bank was exposed to more financial risk than mandated by the agreement and the required financial strength was not maintained as required.

-- The Mission Director had not issued a written certificate establishing the dollar value to be assigned to certificates in the risk minimization fund as required by the pledge agreement under loan agreement 515-0176; as a result, the Mission did not know until informed by BANEX that the market value of the bonds placed in the fund had significantly dropped in value and that the dollar interest associated with these bonds had not been deposited in the fund as required.

-- BANEX had not deposited interest earned on certificates as required in Amplified Project Description Section IV, Part D of loan agreement 515-0176; as a result, about $71,000 in interest was not deposited into the fund as required.

-- COFISA had not established a reserve for bad debts as required by loan agreement 515-0187; as a result, necessary reserves are not in place and one large loan failure could cause the institution serious financial problems. (COFISA had established a reserve for currency devaluation losses for outstanding dollar loans, which, contrary to Mission and COFISA views, is not a reserve for bad debt.)

-- COFISA had not raised $800,000 in equity as contemplated by special covenant 6.1(3) of loan agreement 515-0187; this debt-to-equity ratio had not been raised by the end of the audit and the institution was leveraged more than was contemplated in the loan agreement.

-- PIC had not made an annual provision for bad debts for its equity investments as required by special covenant 6(c) of project agreement 515-0204; therefore, equity investments did not have the same degree of protection as did the loans which had a provision for bad debts.

-- PIC did not comply with AID procurement requirements as required by project agreement 515-0204; as a result, the PIC could not demonstrate that the best prices for goods had been obtained, and Foreign Assistance Act requirements had been adhered to.

These compliance problems relate directly to the lack of a Mission operational directive to ensure that AID Handbook guidance on developmental assistance project monitoring systems is followed. Since no Agencywide systems exist, it is the responsibility of the Bureau or Mission to establish a system that can effectively monitor Borrower/Grantee compliance with AID policies, procedures, and regulations (i.e. developmental assistance special covenants, conditions precedent to disbursement, and other project requirements). USAID/Costa Rica had an automated system for monitoring special covenants under its Economic Stabilization Recovery Program. This system was started because the Mission had experienced difficulties in monitoring its 99 covenants. (Requirements for ESR programs and Developmental Assistance programs are significantly different.)

We concluded that a Mission operational directive was needed to establish a project tracking system for developmental assistance special covenants, conditions precedent to disbursement, and other requirements. Such a system should contain information on the actions to be complied with, deadlines, date of actual accomplishment, description of the evidence needed to document satisfaction of the requirement, a description of the document submitted, and periodic reporting from the project officers responsible for ensuring compliance with project requirements.

Recommendation No. 1

We recommend that USAID/Costa Rica issue operational directives to:

a) establish procedures to ensure the timely preparation of face sheets for project evaluation summaries and the tracking of recommendations contained on the face sheets to ensure effective implementation by assigned offices in accordance with established time frames; and

b) establish a tracking system for all developmental assistance projects to monitor compliance with special covenants, conditions precedent to disbursement, and other project requirements.

USAID/Costa Rica did not consider it necessary to issue an operational directive on project evaluations to ensure their effective and timely implementation. They also did not concur with the recommendation to establish a tracking system for all developmental assistance projects to monitor compliance, claiming they had initiated a Project Management Information System (PROMIS) before receipt of the audit report.

We continue to believe there is a need for an operational directive to establish and mandate the timely preparation of PES face sheets. It may be true that Evaluation Officers have this responsibility but these evaluations were not being addressed in a timely fashion.

Regarding part (b) of the recommendation, much of the Mission response was not relevant since it dealt largely with an ESR tracking system which is not the subject of the audit report. The PROMIS system was not actually functioning at the time of the audit, and the lapses mentioned previously occurred in the four years preceding this audit. A Developmental Assistance Tracking System was only in draft at the time of the audit, as evidenced by the Mission's response to Record of Audit Finding No. 10, dated December 9, 1986, "In the subject exit conference, the Mission promised to provide a draft of the Project Management Information System that is currently being developed by the Project Development Division."

Receipt of a formal operations directive fully describing any system to be put in place will suffice to close this recommendation.

AUDIT OF
USAID/COSTA RICA'S
PROJECT MONITORING SYSTEMS

EXHIBITS AND APPENDICES

8

LOAN REQUIREMENTS NOT EFFECTIVELY MONITORED

A. Condition Precedent to Disbursement 5.1(j) of the BANEX loan agreement required evidence from the borrower that it had entered into an escrow agreement and opened an escrow account for the establishment and maintenance of the "risk minimization fund" as described in Annex I of the loan agreement. The Mission approved the fulfillment of this condition precedent (based on instructions provided in Project Implementation Letter [PIL] No. 1), with the issuance of PIL No. 2. These instructions indicated BANEX should provide certified copies of communications between BANEX and a USAID-approved financial institution committing both parties to a specific contractual relationship to establish and open an escrow account for the risk minimization fund. These instructions were not complied with because the USAID-approved financial institution did not accept the offer to become pledge agent for the risk minimization fund. As a result, some $3,288,825 was disbursed before this initial condition precedent to disbursement was actually met on April 12, 1984.

Furthermore, BANEX did not promptly comply (about two years late) with Special Covenant 6.1(q) which required BANEX to establish and make semiannual payments of three percent of the average outstanding AID loan balance into an escrow account. These deposits were to have started six months after the first disbursement which took place on February 25, 1982. The first deposit was made on February 13, 1984. The Mission stated the deposits had not been made because the account had not been established. An effective monitoring system would have immediately raised the issue of non-compliance with this semiannual deposit requirement. We calculated that the fund was still about $89,000 short.

B. Special Covenant 6.1(y) of the BANEX loan agreement was not complied with for about 14 months. This covenant required the borrower to "not permit its debt to net worth ratio to exceed 6:1 during year one, 7:1 during year two, 8:1 during year three, 9:1 during year four and 10:1 during years five through twenty of the loan agreement." AID officials were apparently unaware that BANEX's debt-to-equity ratio was not in compliance by about June 1985 because they were not requiring quarterly financial statements of BANEX to verify compliance with this requirement. For example, on December 31, 1985 the debt-to-equity ratio was 10.96 to 1. The degree of non-compliance increased as the ratio rose to 12.65 to 1 by June 30, 1986. The USAID project manager was receiving annual audited financial statements and BANEX notified AID of non-compliance on February 27, 1986, about eight months after compliance was no longer present. AID subsequently gave BANEX until August 31, 1986 to achieve compliance with the special covenant. As of that date (the latest available unaudited statements) BANEX was still technically out of compliance with a ratio of about 10.3 to 1 compared to the required ratio of 10 to 1. An effective monitoring system with adequate data submissions would have promptly detected this non-compliance, and corrective actions could have been initiated sooner. An effective monitoring system would have identified what data submissions would have been needed to promptly and timely monitor compliance.

C. Pledge agreement reporting requirements were not adhered to. The account value of any certificates delivered to the pledge agent was to be determined by the AID Mission Director as of the delivery dates of the certificates; the Mission Director was also to issue to BANEX and the pledge agent a written certificate stating the U.S. dollar value assigned to these certificates. We believe a monitoring system would have alerted management that this requirement was not being adhered to.

The Mission did not comply with this requirement even though several such deposits had been made starting in February 1984, totaling a face value of $828,972. According to available information, the estimated value of these certificates had fallen from an initial purchase price of 73 percent of face value to between 35 percent and 48 percent. A good monitoring system would have alerted officials that the value of these certificates was plummeting.

D. Risk minimization fund requirements of the BANEX loan agreement for retaining interest earned on fund investments had not been complied with. Section IV, Part D of the Amplified Project Description states:

> BANEX payments into the fund and earnings thereon less escrow fees, if any, will pass to AID, should AID communicate to the escrow agent that the loan is in default.

This means that AID has exclusive claim on the fund which includes principal and interest earned on these investments. Contrary to this agreement, BANEX did not deposit an estimated $71,089 in interest earnings on dollar-denominated bonds in the risk minimization fund. Instead, BANEX used these scarce dollars for other banking operations contrary to the provisions of the Risk Minimization Fund.

E. COFISA had not established the required reserve for bad debt. Annexes I and II of the loan agreement required COFISA to maintain a reserve for bad debts of not less than two percent of all outstanding loans, and to follow generally accepted accounting principles in reporting this item on its financial statements. COFISA had not established the required reserve nor followed generally accepted accounting principles in the reporting of the reserve on its financial statements. Bad debt reserves are a significant issue for COFISA, for as recently as three years ago they were near bankruptcy. Obviously, to avoid repetition of this problem, an adequate reserve should be set up.

F. PIC did not comply with AID procurement requirements. As a result, PIC had to use its funds to finance $307,953 in subloan costs for commodities, transportation and citrus investments that were ineligible for reimbursement under the AID loan. AID officials did not notify PIC of these requirements. A good monitoring system would have included information on this and other requirements and would have alerted management to remind the PIC of this requirement.

G. Special covenant 6.1(3) required COFISA to raise $800,000 in a public offering of new U.S. dollar-denominated preferred shares during the first three years of the project. This covenant had not been satisfied as of October 31, 1986, although the project was over four years old and the projected completion date is December 31, 1986. Desired financial leverage which is an indication of the financial strength of the bank, had not been achieved.

H. Special covenant 6(c) of the PIC project agreement required that PIC make an annual provision for bad debts of at least two percent of its annual average outstanding loan and investment portfolio. PIC had made an annual provision for its loan portfolio but not for its investment portfolio as of the date of the review. As a result, the equity portfolio did not have the same protection as did the loan portfolio.

AGENCIA PARA EL DESARROLLO INTERNACIONAL
MISION ECONOMICA DE LOS ESTADOS UNIDOS EN COSTA RICA

Apartado Postal 10053
1000 San José, Costa Rica
Teléfono 33-11-55
Telex 3550 AIDCR KR

February 5, 1987

MEMORANDUM

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

THRU: Mr. Daniel A. Chaij, MDIR

FROM: Mr. G. Franklin Latham, Audit Liaison Officer

SUBJECT: USAID/CR Response to RIG Draft Audit Report on Project Monitoring Systems

The USAID/CR Controller's Office has reviewed the abovementioned report for the purpose of assisting the Mission in drafting its response to the RIG. We have met with appropriate individuals and have incorporated their comments. The responsibility of the Controller's Office with respect to the draft audit report is to coordinate the Mission's formal response contained herein. The observations made are in the same format as that of the auditors draft report.

"BACKGROUND" SECTION

USAID/CR has no comments on this section of the auditors' draft report.

"AUDIT OBJECTIVES AND SCOPE" SECTION

USAID/CR has no comments on this section of the auditors' draft report.

"RESULTS OF AUDIT" SECTION

The two conclusions reached by the auditors are not correct, due to major discrepancies regarding the facts which lead to those conclusions as explained below.

The comment that "... the Mission had found that it was unable to adequately track and monitor ..." is not correct. Evidence (in the form of ESR Covenant Compliance sheets) that the Mission was adequately tracking all 99 covenants was provided to the auditors. Even though the new system is automated for quicker and broader access by users of the information, the old manual system was adequate. The new system is simply an improvement.

Additional evidence that the previous manual system was adequate is a 9/16/86 report to AID/W describing the status of the 99 covenants; and that of those 99 covenants USAID/CR is undertaking the official closing of 58 of them. USAID/CR is also discussing with the Central Bank of Costa Rica, how to streamline reporting on the remaining covenants. USAID/CR reports twice a year to Washington on these covenants and the inference that the new automated system for tracking special covenants was established because the "... Mission was unable to adequately track ..." is incorrect.

1. U.S. AID/Costa Rica had not established required systems to ensure the timely and effective implementation of recommendations made in evaluation reports

There appears to be some confusion in this section between fundamentals; a project is first started and subsequently evaluated. Logically, recommendations from evaluation reports are derived from an evaluation performed only after a project has begun.

The wording that "USAID/CR gave first priority to getting projects started with the idea that controls systems would ... follow" is technically correct, but leaves the impression that this strategy caused the project evaluation recommendations to not be promptly implemented. On the contrary, if the Mission had not used that strategy, there would have been no project on which to do an evaluation.

The auditors found no evidence that evaluation recommendations had not been acted upon eventhough PES face sheets (discussed below) had not been prepared.

USAID/CR requests that the abovementioned wording regarding priorities be eliminated from the report.

- Preparation of PES Face Sheets

The preparation of face sheets is now being done, but USAID/CR believes that 30 days is not sufficient time to prepare them. In many cases the evaluation recommendations are complex and require as much as 90 days to determine and negotiate their implementation and prepare the resulting PES face sheets. Rather than fix a specific time limit (which could easily vary from 30 to 90 days depending on complexity) USAID/CR suggests that it fix the time limit internally. The Mission knows it has a responsibility, let the Mission decide. Anything else is purely arbitrary and does not improve efficiency. USAID/CR requests that this recommendation be changed from 30 days to an unspecified period of time to be determined by USAID/CR in accordance with its operating environment.

Discussion

The wording of the first part of this section leaves the impression that

USAID/CR had no Evaluation Officer. Two years ago the Mission recognized its weakness in this area and hired a PSC to be the Mission's Evaluation Officer. This individual left in October 1986 and was therefore not available to the auditors. Nevertheless, these responsibilities were transfered to the Assistant Program Officer for continuation and improvement.

Page 5 as worded leaves the impression that USAID/CR was negligent in following up on the recommendations of the evaluation report which is misleading. While PES face sheets might not have been prepared in 30 days (or even 90 days) action had been taken on all of the recommendations as evidenced by a large volume of correspondence in USAID/CR files. COFISA and BANEX evaluations were still being discussed with the institutions upon arrival of the auditors. USAID/CR doubts that any Mission anywhere has the system recommended by the auditors and questions whether or not the findings, discussion, and recommendations are useful.

USAID/CR believes that much of the commentary in this section is subjective and should be reduced if not eliminated altogether. It is of little use in supporting the auditors conclusion and does not contribute to the improvement monitoring systems.

2. <u>USAID/Costa Rica had not established the required systems to ensure compliance with all special covenants, conditions precedent to disbursement, and other loan and grant requirements</u>

- <u>Establishment of Risk Minimization Fund</u>

It is clear that the "establishment" of the fund was not complied with on a timely basis; however, the fund once established was properly "maintained."

This issue is discussed further in USAID/CR's response to the RIG draft audit report on BANEX project No.515-0176 and need not be repeated here.

USAID/CR requests that the language here be modified to reflect that although the fund establishment requirement was not met on a timely basis, the fund maintenance requirement was complied with.

- <u>BANEX Debt to Equity Ratio</u>

USAID/CR does not agree with the auditors' finding that "for 14 months, BANEX did not comply with the debt-to-equity ratio requirements ...". USAID/CR maintains that the ratio should be computed based on the consolidated balance sheet of the company. Since the consolidation is only done annually and USAID/CR accepts only the audited balance sheet as reliable data for the calculation, BANEX was out of compliance 2 months, not 14 months.

Consequently, this example of "the effects of not having ... a monitoring system in place" is not correct. The BANEX debt-to-equity issue did not escape the timely attention of USAID/CR. USAID/CR requests that all references to this issue be eliminated from the auditors' final report on project monitoring systems.

The debt-to-equity issue is also treated in further detail in USAID/CR response to the RIG auditors' draft report on the BANEX project No.515-0176.

- Value of Certificates in Fund

Auditors' description of the facts is adequate. USAID/CR has no further comment.

- Deposit of Interest Earned on Certificates

The comment that "for 30 months, BANEX did not deposit interest earned on certificates as required ..." is correct in form but not in substance, when viewed in light of the bureaucratic nature of the Costa Rican banking environment. While it is true that BANEX did not leave the interest coupons in the fund (which have a collection period of up to three or four months), BANEX did put an equivalent amount in the fund in the form of new certificates in the fund. This did not diminish the total amount which AID could lay claim to in the event of default on the loan. Since BANEX technically complied with the requirement, USAID/CR believes that this issue is not evidence of the lack of adequate monitoring systems and does not support the conclusion reached by the auditors regarding monitoring systems; and, consequently, the issue should be eliminated from the final report.

For the auditors' reference, this issue is treated in further detail in USAID/CR's response to the RIG's draft audit report on the BANEX project No.515-0176.

- COFISA Reserve For Bad Debts

USAID/CR has consulted COFISA's auditors as well as another audit firm regarding the accounting treatment for the reserve for bad debts. Both audit firms concurred with the Mission that the accounting treatment for the reserve for bad debts was, 1) in accordance with generally accepted accounting principles and 2) in accordance with the loan agreement. The fact that there is a difference of professional opinion between RIG auditors and local authoritative opinion, does not constitute non-compliance on the part of COFISA. Consequently, the statement that "for 49 months, COFISA did not establish a reserve for bad debts as required ..." is not correct.

This issue is treated extensively in USAID/CR's response to the RIG draft audit report on the COFISA project No. 515-0187.

USAID/CR maintains that this issue is not evidence of the lack of monitoring systems and does not support the conclusion reached by the auditors with regard to such systems. USAID/CR requests that all reference to this issue be eliminated from the auditors' final report on monitoring systems.

- COFISA Staff Development Plan

The statement that "for 25 months, COFISA did not submit an acceptable staff development plan as required by conditions precedent ..." is not correct.

Curiously, this issue is not mentioned in the draft audit report on the COFISA project No.515-0187, nor should it be.

The original staff development plan was accepted but never implemented because of the uncertainty of survival of COFISA until the debt settlement was made. Logically, any staff development plan would not have been implemented. After the debt settlement, COFISA submitted a revised plan which was also accepted. COFISA has never been out of compliance with this condition precedent.

USAID/CR maintains that the staff development plan issue as presented by the auditors is not correct and should be eliminated from the final report on monitoring systems.

- Equity Capital Contribution

The increase of $800,000 in equity capital was not "required" as stated in the auditors' report, rather the loan agreement says that COFISA would "use its best efforts" to raise this capital. Consequently, there is no non-compliance. Exhibit 1.H. of the auditors report gives no evidence that COFISA did not use its best efforts, only that the goal was not achieved.

This issue is treated in detail in USAID/CR's response to the draft audit report of COFISA project No.515-0187.

Since there is no non-compliance, this issue does not provide evidence that USAID/CR's monitoring systems are inadequate. AID/CR requests that this issue be eliminated from the final report on monitoring systems.

- PIC Provision for Bad Debts

The equity investment portfolio of PIC has been outstanding for less than six months. Technically then, there is no non-compliance. Nevertheless, such a provision was made prior to the completion of the auditors' review. Since there was compliance, this issue does not support the auditors' conclusion as to the adequacy of project monitoring systems.

USAID/CR requests that all reference to this issue be eliminated from the auditors' final report on monitoring systems.

- AID Procurement Requirements

All loans funded with AID funds complied with this provision. The loans which did not comply were funded with PIC's own resources. Since there was total compliance, this issue is not relevant to the inadequacy of monitoring systems. Nevertheless, USAID/CR sponsored a ROCAP advisor to give special attention to PIC in this area. USAID/CR requests that all references to this issue be eliminated from the auditors final report on project monitoring systems. This issue is treated also in USAID/CR's response to the draft audit report of PIC project No.515-0204.

- Lack of Mission Operational Directive

That the auditors "... believe that these compliance problems relate directly to the lack of a Mission operational directive ..." infers that the Mission was unaware of compliance problems - not true. As explained in detail above, many of the "compliance problems" are in fact neither problems nor instances of non-compliance. Consequently, the conclusion that an operational directive is needed is not appropriate. Once the above comments are considered, the nine "compliance problems" are really only two and hardly justify a Mission operational directive.

- Recommendation No.1

Issue operational directives to:

a) "Establish procedures to ensure timely preparation of face sheets ..."

- USAID/CR considers it not necessary to issue an operational directive on this. The Evaluation Officer already has this responsibility.

b) "Establish a tracking system for all projects to monitor compliance..."

- As described above, the tracking system for ESR funds already existed prior to establishing the automated system. Further, the Mission had initiated a Project Management Information System (PROMIS) for all direct assistance projects before reciept of the auditors draft report. The Mission previously used a clearance system to assure compliance with conditions precedent as well as other important covenants. The inference that no system existed at all is not correct.

Exhibit 1

A. Establishment of Risk Minimization Fund

The "maintenance" of the fund was complied with whereas the "establishment" of the fund was not.

This issue is discussed further in USAID/CR's response to the draft audit report on BANEX project No.515-0176 and need not be repeated here.

USAID/CR requests that the language in part A of Exhibit 1 be modified to reflect that although the fund establishment requirement was not met on a timely basis, the fund maintenance requirement was complied with.

B. BANEX Debt-to-Equity Ratio

As explained above, USAID/CR does not agree with this finding and requests that it be eliminated from the auditors final report on monitoring systems.

C. Value of Certificates in Fund

Auditors' description of the facts is adequate. USAID/CR has no further comment.

D. Deposit of Interest Earned on Certificates

As explained in detail above, BANEX complied with this requirement. USAID/CR requests that this issue be eliminated from the auditors' final report on project monitoring systems.

E. COFISA Bad Debt Reserve

As explained above, COFISA has complied with this requirement and USAID/CR requests that all references to this issue be eliminated from the auditors' final report on project monitoring systems.

F. AID Procurement Requirements at PIC

As explained above, PIC complied with this requirement. USAID/CR requests that all references to this issue be eliminated from the auditors' final report on project monitoring systems.

G. COFISA Staff Development Plan

As explained above, COFISA complied with this requirement. USAID/CR requests that all references to the staff development plan be eliminated from the auditors' final report on project monitoring systems.

H. COFISA Equity Capital Contribution

As explained above, COFISA has complied with this requirement and USAID/CR requests that all references to this issue be eliminated from the auditors' final report on project monitoring systems.

I. PIC Provision for Bad Debts

The equity investment portfolio of PIC has been outstanding for less than six months. Technically then, there is no non-compliance. Nevertheless, such

18

a provision was made prior to the completion of the auditors' review. Since there was compliance, this issue does not support the auditors' conclusion as to the adequacy of project monitoring systems.

USAID/CR requests that all reference to this issue be eliminated from the auditors' final report on monitoring systems.

CONCLUSION

The auditors found no substantive issues to support their conclusions that, (1) USAID/Costa Rica had not established required systems to ensure the timely and effective implementation of recommendations made in evaluation reports, and only two issues that (2) USAID/Costa Rica had not established the required systems to ensure compliance with all special covenants, conditions precedent to disbursement, and other loan and grant requirements.

The auditors final report should state that "no material weaknesses were noted in the Mission's project monitoring systems."

APPENDIX 2

REPORT DISTRIBUTION

	No. of Copies
Director, USAID/Costa Rica	5
AA/LAC	2
LAC/CAP/CR	1
LAC/DR	1
LAC/DP	1
LAC/PS	1
LAC/CONT	1
LAC/GC	1
LAC/RLAs	1
AA/M	1
AA/PRE	1
PRE/PR	1
PRE/PD	1
PRE/I	1
GC	1
LEG	1
M/FM/ASD	3
PPC/PDPR	1
PPC/CDIE	3
AA/XA	2
XA/PR	1
IG	1
AIG/A	1
IG/PPO	2
IG/LC	1
IG/EMS/C&R	12
IG/II	1
RIG/II/T	1
Other RIG/As	1

vp