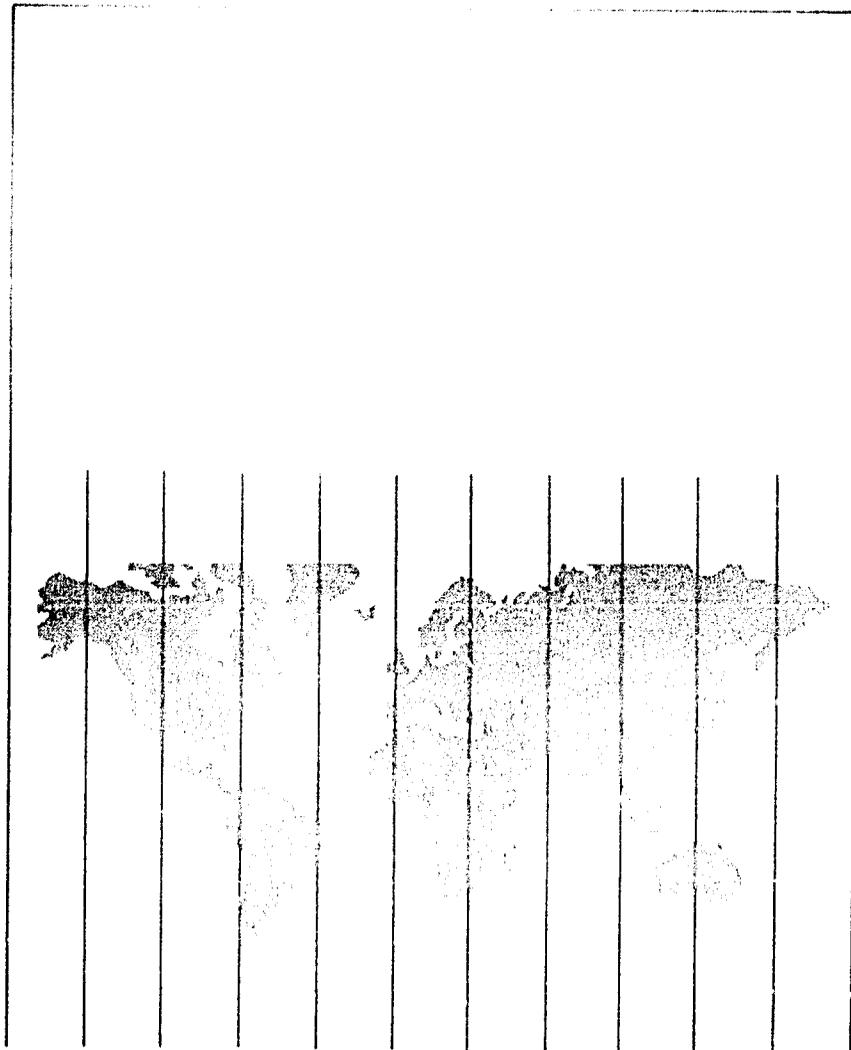


UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE
INSPECTOR
GENERAL



Regional Inspector General for Audit
TEGUCIGALPA

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AUDIT OF
USAID/PEER
PUBLIC LAW 480 TITLE I
AND SECTION 416 PROGRAMS

Audit Report No. 1-527-89-01
October 18, 1988

AGENCY FOR INTERNATIONAL DEVELOPMENT

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October 18, 1988

MEMORANDUM

TO : Director, USAID/Peru, Donor M. Lion

FROM : RIG/A/T, *Leiniger N. Gotthard*
Leiniger N. Gotthard, Jr.

SUBJECT: Audit of USAID/Peru Public Law 480 Title I and Section 416 Program

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of the USAID/Peru Public Law 480 Title I and Section 416 programs. Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached as Appendix I to this report. The report contains four recommendations. All four recommendations are unresolved. Please advise me within 30 days of any actions taken to implement these recommendations.

I appreciate the cooperation and courtesy extended to my staff during the audit.

Attachments: a/s

EXECUTIVE SUMMARY

The Agricultural Trade Development and Assistance Act of 1954, referred to as the Public Law 480 program, consists of concessional sales of agricultural commodities from the United States, such as grains and vegetable oil, to friendly countries on favorable credit terms. Recipient governments sell these commodities to the private sector and/or directly to the public. Section 416 of the Agricultural Act of 1949 also authorizes the foreign donation of eligible agricultural commodities to developing, friendly countries. The sale of the commodities to the Government of Peru generated local currency proceeds that were used to finance projects for food assistance to the needy population as agreed upon with A.I.D. Under the Public Law 480 programs for 1985 and 1986, Peru imported approximately 350,000 metric tons of vegetable oil, rice, and wheat, generating the local currency equivalent of approximately \$50 million in sales proceeds.

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a program results audit of USAID/Peru's Public Law 480 Title I and Agricultural Act of 1949, Section 416 Sugar Quota programs. This audit was selected because of U.S. Congressional interest in local currency uses. The audit objectives were to determine whether the local currencies generated by the commodity sales were effectively used to promote economic development and self-help initiatives and if they were provided in accordance with the respective commodity sales agreements.

The audit disclosed that the Government of Peru had not provided appropriate evidence that it had effectively used Public Law 480 Title I sales proceeds for mutually agreed upon projects nor had it accounted for all the commodity sales proceeds in accordance with the respective commodity agreements.

USAID/Peru generally agreed that the program needed to be more effectively managed. Even before the audit, it had taken steps toward that objective, such as designating an individual to manage the program on a full-time basis and drafting an internal written guide to delineate management's responsibilities. However, USAID/Peru did not agree with our conclusions under findings 1 and 2. We have made modifications to address USAID/Peru's concerns, but we have retained the essence of findings 1 and 2 as presented in the draft report. A full text of USAID/Peru's response to the draft report is attached as Appendix 1.

This report contains four findings which note that the program was not effectively managed to ensure compliance with the Public Law 480 agreements. First, Public Law 480 proceeds were not applied to approved development projects. Second, some Public Law 480 sales proceeds were withdrawn for unknown purposes and third, others were not deposited as required. Finally, the program's accounting and reporting systems were inadequate.

Public Law 480 Title I agreements require that local currency proceeds generated from the sale of PL 480 commodities be used to fund mutually

agreed upon projects. Memoranda of Understanding to the 1986 and 1987 Title I agreements stipulate that the Government of Peru establish an effective maintenance-of-value plan to preserve the purchasing power of the sales proceeds. However, the Government of Peru had not used the sales proceeds from the April 1985 and August 1986 PL 480 Title I and Section 416 sales agreements because they were still on deposit in special accounts. Furthermore, the Government of Peru had not established an appropriate maintenance-of-value plan. Numerous inquiries of cognizant A.I.D. and GOP officials during the audit did not produce satisfactory or clear explanations why the GOP had not used the PL 480 resources nor why a maintenance-of-value plan had not been established in a timely manner. The lack of a proper plan has resulted in a loss in value of the original sales proceeds. Over 800,000,000 Intis, worth about \$58 million at the time of deposit, have been reduced by Peru's high inflation to their current value of about \$23 million in local currency purchasing power. The report recommends that USAID/Peru demonstrate that the Government of Peru properly expended the commodity sales proceeds and that it can maintain the value of the proceeds until they are used. USAID/Peru did not agree with the finding and recommendation.

The Government of Peru had taken the amount of I/. 13.0 million (approximately \$935,000 at the rate of I/. 13.95 per US\$) from the special accounts without mutual agreement with the U.S. Government and has used the funds for unknown purposes. Memoranda of Understanding to both the 1985 and 1986 Public Law 480 Title I agreements require that sales proceeds, including interest, in the special accounts be programmed and used for jointly agreed upon activities. Neither Government of Peru nor USAID/Peru officials could state why the funds were withdrawn nor where and how the funds were used. To the extent that the funds were not used for mutually agreed upon projects, those projects will ultimately suffer or potential projects will not be developed. The report recommends that USAID/Peru demonstrate that the withdrawn funds have been redeposited and approved for use by the Mission. USAID/Peru did not agree with the finding or recommendation.

The last two findings note that the Government of Peru had not deposited the full amount of commodity sales proceeds under the 1986 program nor had the Government of Peru provided the required certified reports on the receipts, expenditures, and interest earned on local currency sales proceeds. The report recommends that all the 1986 sales proceeds, including applicable interest, be made available for jointly approved projects and that the Government of Peru adhere to reporting requirements. In general, USAID/Peru agreed with these two findings but asked for modifications on certain parts of the recommendations.

Office of the Inspector General

AUDIT OF
USAID PERU
PUBLIC LAW 480 TITLE I
AND SECTION 416 PROGRAM

TABLE OF CONTENTS

	<u>Page</u>
PART I - INTRODUCTION	1
A. Background	1
B. Audit Objectives and Scope	2
PART II - RESULTS OF AUDIT	3
A. Findings and Recommendations	4
1. Public Law 480 Sales Proceeds Were Not Effectively Applied to Approved Projects	4
2. Government of Peru Withdrew Funds from Special Local Currency Accounts for Unknown Purposes	9
3. The Correct Amount of Commodity Sales Proceeds Was Not Deposited into the Special Accounts	11
4. Systematic Accounting, Record-keeping, And Reporting Was Lacking	13
B. Compliance and Internal Control	17
1. Compliance	17
2. Internal Control	17
C. Other Pertinent Matters	18
PART III - APPENDICES	
1. Mission Comments	
2. List of Recommendations	
3. Report Distribution	

AUDIT OF
USAID/PERU
PUBLIC LAW 480 TITLE I
AND SECTION 416 PROGRAM

PART I - INTRODUCTION

A. Background

The Agriculture Trade Development and Assistance Act of 1954, referred to as the Public Law (PL) 480 program, states among others the following objectives for the International Food Assistance Program: 1) to promote agricultural trade, 2) to provide humanitarian relief, and 3) to assist developing countries to advance economically. Responsibility for accomplishing these objectives is shared by various governmental agencies. Executive Order No. 12220, dated June 27, 1980, delegated authority for the program to the International Development Cooperation Agency. A.I.D. has primary responsibility for the administration of the Public Law 480 program.

The PL 480 Title I program consists of concessional sales of agricultural commodities from the United States to friendly countries on favorable credit terms. Recipient governments sell these commodities to the private sector and/or directly to the public. As a result of food shortages and lagging economic progress in developing countries, the Act was amended in 1966 to require the recipient governments to establish programs of self-help to improve agricultural production, health, and education of the rural poor using local currency proceeds from PL 480 sales. Also, the Agricultural Act of 1949, Section 416 Sugar Quota provides for the donation of surplus commodities to developing, friendly countries to carry out assistance programs.

The Government of Peru (GOP) had made some progress in improving the economic welfare of its people but could not sustain that progress nor deal with the basic social problems affecting the economy. Per capita income is lower than 10 years ago and about the same as it was 20 years ago. Outside Lima, malnutrition levels are high and over half the children under age six suffer from chronic malnutrition. Health conditions are poor in general, particularly so in the rural areas where agriculture has not recovered from the statist policies of the military government of the 1970s. The leftist insurgency, terrorist movements, and the illegal coca trade also create obstacles to restoring social and economic growth.

To assist the GOP in reversing the economic decline, USAID/Peru established a strategy to support the government's balance-of-payments and long-term development objectives using the PL 480 Title I program and other resources. The sale of the commodities provided to Peru generate local currency proceeds that are used to finance mutually agreed upon projects. For the period 1985-1986, Peru imported approximately 350,000 metric tons of vegetable oil, rice, and wheat under Title I and Section 416, generating approximately \$50 million in gross sales proceeds.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit (Tegucigalpa) performed a program results audit of USAID/Peru's Public Law 480 Title I and Agricultural Act of 1949, Section 416 Sugar Quota programs. This audit was selected because of U.S. Congressional interest in local currency uses. The audit objectives were to determine whether the local currencies generated by the commodity sales were effectively used to promote economic development and self-help initiatives and if they were provided in accordance with the respective commodity sales agreements. This audit was conducted during the period November 4, 1987, to March 25, 1988 and did not review how the PL 480 commodities were used after they had been sold.

To accomplish the objectives, audit fieldwork included both reviews of pertinent files, records, and reports and interviews with officials and staff at USAID/Peru, the U.S. Department of Agriculture, the U.S. Embassy, the Government of Peru Ministry of Economy and Finance, various implementing agencies, the National Bank of Peru, and with importers. Visits were made to offices of 20 of the 37 projects funded with PL 480 Title I and Section 416 sales proceeds under the FY 1986 program. The audit covered about \$55.8 million in sales proceeds under the agreements for fiscal years 1985 and 1986. The agreements for FY 1987 were also included in our audit but sales of the commodities had not yet been completed at the time of the audit. The extent of internal controls reviewed was limited to the issues in this report. The audit was made in accordance with generally accepted government auditing standards.

In this report an exchange rate of 13.95 Intis to \$1 was used unless otherwise specifically noted. The 13.95 Inti to \$1 rate was the average official rate of exchange in effect during the period when the commodities under review arrived in Peru and when most of the sales proceeds were deposited into special accounts.

AUDIT OF
USAID PERU
PUBLIC LAW 180 TITLE I
AND SECTION 116 PROGRAM

PART II - RESULTS OF AUDIT

The audit disclosed that the Government of Peru had not provided appropriate evidence that it had effectively used Public Law 180 Title I sales proceeds for mutually agreed upon projects nor had it accounted for all the commodity sales proceeds in accordance with the respective commodity agreements.

USAID-Peru generally agreed that the program needed to be more effectively managed. Even before the audit, it has taken steps toward that objective, such as designating an individual to manage the program on a full-time basis and drafting an internal written guide to delineate management's responsibilities.

The audit's four findings show that the program was not managed in compliance with the PL 180 agreements. PL 180 sales proceeds were not applied to identifiable development projects; some sales proceeds were withdrawn for unknown purposes; others were not deposited as required; and the program's accounting and reporting systems were inadequate.

This report recommends that USAID-Peru provide evidence that the GOP has expended the commodity sales proceeds on mutually agreed upon development projects; has implemented maintenance of value procedures over sales proceeds; has deposited and accounted for all applicable sales proceeds and interest earned thereon; and is providing the required certified reports on the receipts and expenditures of the local currency sales proceeds and interest earned.

A. Findings and Recommendations

1. PL 480 Sales Proceeds Were Not Effectively Applied to Approved Projects

Public Law 480 Title I agreements require that local currency proceeds generated from the sale of PL 480 commodities be used to fund mutually agreed upon projects. Memoranda of Understanding to the 1986 and 1987 Title I agreements stipulate that the Government of Peru establish an effective maintenance-of-value plan to preserve the purchasing power of the sales proceeds. However, the Government of Peru had not used the sales proceeds from the April 1985 and August 1986 PL 480 Title I and Section 416 sales agreements because they were still on deposit in special accounts. Furthermore, the Government of Peru had not established an appropriate maintenance-of-value plan. Numerous inquiries of cognizant A.I.D. and GOP officials during the audit did not produce satisfactory or clear explanations why the GOP had not used the PL 480 resources nor why a maintenance-of-value plan had not been established in a timely manner. The lack of a proper plan has resulted in a loss in value of the original sales proceeds. Over 800,000,000 Intis, worth about \$58 million at the time of deposit, have been reduced by Peru's high inflation to their current value of about \$23 million in local currency purchasing power.

Recommendation No. 1

We recommend that USAID/Peru:

- a. provide evidence that the Government of Peru had expended sales proceeds generated under Public Law 480 Title I and Section 416 agreements for support to mutually agreed upon development projects,
- b. obtain from the Government of Peru evidence that effective maintenance-of-value measures have been implemented and funds currently on deposit be adjusted accordingly, and
- c. in conjunction with the Government of Peru, develop a mechanism to expedite the offsetting of actual Public Law 480 Title I and Section 416 local currency sales proceeds against reported expenditures for the mutually agreed upon projects.

Discussion

Pursuant to the terms of the PL 480 Title I agreements, the GOP deposited commodity sales proceeds into special accounts in the National Bank of Peru (Banco de la Nacion) for subsequent programming and disbursement to mutually agreed upon projects. The special account included deposits of commodity sales proceeds under the 1985 and 1986 agreements totalling about \$55.3 million and interest earned of \$2.6 million. 1/ The GOP had deposited \$5.3 million more than required in the PL 480 Title I agreements.

The GOP's system was to disburse funds from its General Fund to finance the various approved projects. That is, the GOP would fund the designated PL 480 supported projects through its normal budget and disbursing system. USAID/Peru officials stated that, at the end of the budget year or close thereto, the General Fund was to be reimbursed with funds from the special accounts.

In accordance with the PL 480 sales agreements and other related documentation, these local currency sales proceeds were generally to be used to finance high priority, mutually agreed upon projects activities in the areas of agriculture and nutrition. In practice, the monies on deposit in the special accounts were to be used to reimburse the GOP for advances it had made from its own resources to provide counterpart contributions to A.I.D. and other donor-funded projects in these areas. Such reimbursements were expected to occur on an ongoing basis to minimize the drain on the GOP's own resources. Moreover, A.I.D.'s Policy Determination No. 5, dated February 12, 1983, states that, "The sales proceeds should be spent as closely as possible to the time PL 480 imports are used in order to minimize the net inflationary or deflationary effects of the agreement."

However, in the case of the 1985 and 1986 programs, the GOP had not followed its system of reimbursing the General Fund from the special accounts. Pursuant to the 1985 and 1986 agreements, the GOP deposited the equivalent of \$55.3 million of commodity sales proceeds into the special accounts. The first deposit was made on February 21, 1986, and the last on September 22, 1987. As of mid-March 1988, these funds plus accumulated interest were still on deposit ^{2/} in the special accounts, over two years after the first deposit of sales proceeds was made. Nevertheless, the GOP had reportedly funded the USAID/Peru and other donor PL 480 designated projects from its own resources during 1986 and 1987 (even though the GOP is purportedly short of funds), yet it had not drawn on the special accounts to offset these expenses. If this were in fact the case, then it would raise a question about the GOP's actual need for Title I local currency resources. In other words, the GOP would appear to be able to support the mutually programmed activities from its own funds, given the fact that it had not reimbursed itself for two years for such support from the sales proceeds on deposit in the special accounts.

^{1/} Figure includes \$934,800 withdrawn from the special accounts by the Government of Peru for unknown reasons. This issue is discussed in Finding 3 on page 11.

^{2/} See footnote 1.

However, our review of 20 of the 35 projects, for which Fiscal Year 1986 PL 480 commodity sales proceeds had been programmed, disclosed that the flow of GOP counterpart contributions had not been satisfactory. For example:

- 12 project officials reported that their original budget requests had been lowered by the GOP.
- 10 stated that they received less than the approved budgeted amounts.
- 15 said that they did not receive the funds on time.
- 13 stated that their projects were delayed due to insufficient funds.
- 10 reported that their projects were delayed due to lateness of funds.

Of even greater significance, the non-utilization of the sales receipts, be it the result of design or oversight, has resulted in a significant diminution in their value from the time they were deposited in the special accounts until such time as they are eventually used. The Peruvian economy has been seriously affected for some time by inflation which has averaged 37 percent annually according to the U.S. Embassy economist in Lima. Thus, notwithstanding the interest being earned on the sales receipts and the fact that the GOP had, at least partially, supported approved projects from other fund sources, the value of the sales proceeds has been reduced substantially since they were deposited and such erosion in value will continue until they are eventually tapped for some worthwhile purpose.

Memoranda of Understanding (MOU) to the 1985, 1986 and 1987 PL 480 Title I agreements and to the 1986 and 1987 Section 416 agreements require the GOP to deposit proceeds accruing from the sales of agricultural commodities covered under the agreements into special accounts in the National Bank. The MOUs to the August 1986 agreements further require that "Within one month of the signing of this Agreement, the Government of Peru will provide a plan for the maintenance of value of these funds in form and substance satisfactory to A.I.D." The maintenance-of-value requirement is also included in the MOU of July 1987.

As of July 1987, nearly a year after it was due, the Government of Peru had still not provided a maintenance-of-value plan. On August 27, 1987, over a month after the 1987 PL 480 Title I agreement was signed, the GOP's Ministry of Economy and Finance presented USAID/Peru a copy of a letter opening 36 long-term (360 day) interest-bearing accounts in the National Bank. A total of \$50,300,000 of the \$55,300,000 in net sales proceeds on deposit in the National Bank was transferred to the 36 accounts, which were to accrue interest at 12 percent annually. The Ministry of Economy and Finance considered the August 27, 1987 letter a fulfillment of the required maintenance-of-value plan. However, during the audit our inquires disclosed no documented or other evidence that USAID/Peru considered the August 27, 1987, letter an acceptable maintenance-of-value plan. In any case, the above situation had at least

three negative implications regarding the PL 489 program: (1) the 1987 PL 489 Title I and Section 41c Agreements were signed without the GOP having adhered to a requirement of the 1986 agreements, (2) a letter opening long-term savings accounts does not in and of itself constitute a maintenance-of-value plan, and (3) only \$55,500,000 of the total \$55,500,000 was transferred to interest-bearing long-term accounts.

Because there had been no effective plan, the \$55,500,000 equivalent value in net sales proceeds from the 1985 and 1986 agreements may have lost more than half its deposited value as of September 30, 1987, even though nearly \$2,500,000 in interest had accrued on the funds as of that date. As of mid-March 1988 funds worth a total of \$57,900,000 were still on deposit in the special accounts. 5

Net commodity sales proceeds were deposited to the special accounts at various times during the period February 1985 to September 1987. Also the GOP was providing funds to the jointly approved projects albeit not directly from the designated special accounts and, we believe, not timely nor in sufficient amounts as noted earlier. Because of the various deposit dates and given the fact that GOP monies were flowing to the projects, a precise loss of value cannot be calculated. Nevertheless the average annual inflation rate in Peru during the period 1985 to September 1987 was about 87 percent. Therefore if one takes the original \$55,500,000, at its September 1987 real value of about \$20,700,000, plus the nearly \$2,000,000 earned in interest, the total is \$22,700,000, which leaves the fund about \$32,000,000 in local currency purchasing power short of the original value of the sales proceeds.

Management Comments

USAID/Peru officials did not agree with the draft report finding and recommendation. The Mission's detailed response disagreed because: 1) the auditor's acknowledged that funds were disbursed to projects, so the report's conclusion was wrong in stating that funds were impounded; 2) the GOP used the sales proceeds to reimburse themselves for funds disbursed to mutually agreed on projects; 3) the maintenance of value provisions of the agreement no longer applies once the funds were spent and that documentation was provided that shows all 1985 funds were disbursed; 4) there was a mechanism in place to expedite the disbursement of sales proceeds; 5) the audit report uses an incorrect inflation rate to compute the sales proceeds loss of value; and 6) the statistics in the report do not support the conclusion because USAID/Peru cuts budgets to projects. In addition, USAID/Peru management requested the opinion of 10 USAID/Peru project managers on the auditor's finding of delayed resources to the projects and they disagreed with the audit results.

Office of Inspector General Comments

Based on USAID/Peru's response to the draft report we have revised finding No. 1 and the recommendation. We have rewritten recommendation

3/ See footnote 1, page 5.

No. 1a. and c. (part d in the draft) and have incorporated part b. of the draft report into recommendation No. 4a. of this report.

To address number one under Management Comments above, the report was changed accordingly. Point number two, the Mission's response did not address the fact that for the fiscal year 1985 program there was \$25 million in local currency sales proceeds deposited in the special account, however, the GOP only allocated about \$16 million in local currency to projects and then only disbursed about \$11 million. The Mission's response stated that all fiscal year 1985 disbursements had been completed. The Mission should provide documentation for the fiscal year 1985 program along with a statement of deposits and expenditures for the fiscal year 1986 Public Law 480 Title I. These reports should also include the programming and disbursements for the interest income earned on deposits.

The maintenance of value discussion in number three above becomes important when the disbursements were not made as was the case in the fiscal year 1985 program when approximately \$14 million in local currency still has not been disbursed.

Point number four, the Mission needs to provide documentation that the special accounts had been liquidated either through actual disbursements to projects or offsets as reimbursement to the Government of Peru. Point number five, the 87 percent inflation rate used in the audit report was obtained from the Economic Section, U.S. Embassy-Peru calculated for the audit period. In addition, the data used in the calculation was taken from official Government of Peru statistics. We consider this information valid for audit report purposes.

Point number six, the statistics in the audit report were the interview results of implementing agency project managers and not USAID/Peru project managers. As stated in finding No. 2, USAID/Peru project officials were not always aware of their Public Law 480 Title I responsibilities and the Mission was developing a Mission Order that identifies the project officials duties. We believe the results of interviews with project implementing officials' indicated there were sufficient problems of disbursements to the projects for Mission officials to determine if Public Law 480 Title I sales proceeds were used for developmental projects.

2. Government of Peru Withdrew Funds from Special Local Currency Accounts For Unknown Purposes

The Government of Peru had taken the amount of I/. 13.0 million (approximately \$935,000 at the rate of I/. 13.95 per US\$) from the special accounts without mutual agreement with the U.S. Government and had used the funds for unknown purposes. Memoranda of Understanding to both the 1985 and 1986 Public Law 480 Title I agreements require that sales proceeds, including interest, in the special accounts be programmed and used for jointly agreed upon activities. Neither Government of Peru nor USAID/Peru officials could state why the funds were withdrawn nor where and how the funds were used. To the extent that the funds were not used for mutually agreed upon projects, those projects will ultimately suffer or potential projects will not be developed.

Recommendation No. 2

We recommend that USAID/Peru obtain relevant evidence that the equivalent of \$934,813 in local currency (Intis) has been redeposited into the special accounts and approved for use by the Mission.

Discussion

The 1985 and 1986 Public Law (PL) 480 Title I agreements and their respective Memoranda of Understanding (MOU) called for the Government of Peru (GOP) to maintain the local currency value of the sales proceeds by depositing the funds into interest-bearing special accounts to offset the effects of inflation. The same agreements state that any proceeds including interest earned should be programmed jointly between the GOP and USAID/Peru. For example, the 1986 MOU states that "The Government of Peru agrees to deposit the proceeds accruing from the sales of agricultural commodities covered under the Agreement into a special account in the Banco de la Nacion" and it further states that "...the Government of Peru will provide a plan for the maintenance of value of these funds in form and substance satisfactory to AID," and that "...the balances to be carried over to the following year will be based on the difference between the total amount to be used...plus the increases generated by the maintenance-of-value plan, and the total of the giros [disbursements]..." Therefore, the increases, in this case the interest earned, are to be programmed jointly by the GOP and USAID/Peru and not be expended without their mutual agreement.

The proceeds from the sale of commodities under the above sales agreements were deposited in four special accounts. Our analysis of the relevant statements disclosed that the sales proceeds were being credited with interest monthly. According to available bank statements the GOP had deposited the equivalent of \$55,300,000 in Intis from the net sales proceeds of commodities under the 1985 and 1986 Title I and 416 agreements into the four special accounts. These same bank statements showed that the equivalent of \$2,580,000 had been earned in interest as of September 30, 1987.

However, the GOP did not adhere to the sales agreements, but rather withdrew local currency worth \$934,813, which was part of the interest earned over the period October 1986 to June 1987. USAID/Peru and GOP officials we interviewed could not explicitly state why these funds had been withdrawn other than to make reference to Peruvian Law No. 24582, Article 5. This article establishes that "All accounts maintained by the Public Treasury in the National Bank should be gathered in only one account (cuenta unica). In required cases there will be sub-accounts for specific purposes, with separate handling and control. Interest will be credited monthly at the end of operations on the balance of this account" (RIG/A/T translation from Spanish). As can be noted, there is no reference in the article to withdrawing interest earned and in any case the law did not become effective until May 29, 1987, after \$854,716 of the \$934,813 in Intis had already been transferred.

Unless these Intis are redeposited to the appropriate special accounts and/or jointly programmed and used, a significant amount of potential self-help and rural poor development projects in Peru will go unrealized. For example, \$934,000 in Intis could fund a child feeding program for a year or a vital reforestation program for nearly three years, based on fiscal year 1986/1987 GOP funding levels.

Management Comments

USAID/Peru did not agree with this finding. Management stated in its response to the draft report that: "The USAID does not believe that this section should be included in the final audit, since the USAID has provided information to the RIG auditors demonstrating that the I/. 13.0 million removed from the special subaccounts, plus the amounts in the special subaccounts from the FY 1985 agreement, had been used for jointly agreed development projects by the end of 1986. USAID/Peru further stated that in demonstrating the above, it is not required to show actual transfer of funds from one subaccount to another subaccount, and then to accounts of approved projects, but only to demonstrate that actual disbursements to mutually approved projects, in amounts that do not exceed those approved by the USAID, are equal to or exceed the total amount of sales proceeds and interest that are available for programming to jointly agreed projects."

USAID/Peru provided documentation which, it said, showed that the GOP had spent, from its own sources, an amount of Intis on jointly approved projects that exceeded the amount of sales proceeds deposited from the PL 480 program.

Office of Inspector General Comments

While USAID/Peru has provided evidence that the GOP has spent an amount of money on projects that would be enough to account for the \$934,813, USAID/Peru's response still does not address the concerns raised in this finding. OIG comments for finding No. 1 address the need for documentation to support the Mission statement that all FY 1985 sales proceeds were used. Recommendation No. 2 stands until USAID/Peru receives the certified reports on the receipts and expenditures of the sales proceeds (underscoring added) for the 1985, 1986 and 1987 PL 480 Title I agreements.

3. The Correct Amount Of Commodity Sales Proceeds Was Not Deposited Into the Special Accounts

The Peruvian wheat importing agency deposited at least 151 million (\$10.8 million) fewer Intis into the special account than it should have deposited, based on sales proceeds generated pursuant to the August 1986 PL 480 Title I agreement. The PL 480 Title I agreements and related Memoranda of Understanding, permit the Government of Peru importing agencies to deduct the ocean freight differential 4/, insurance, Currency Use Payments and other actual expenses from the sales proceeds in determining the net amount of local currency to be deposited to the special accounts and programmed for projects. But, for reasons never made clear by the Peruvian wheat importing agency, it did not deposit the entire amount of the net sales proceeds, causing this shortfall. By not depositing the proper amount into the special account and making it available for programming, projects and activities were not funded to the extent they could have been and neither the intent nor the letter of the agreement was achieved.

Recommendation No. 3

We recommend that USAID/Peru obtain relevant evidence from the Government of Peru that the equivalent of \$10,806,000 in local currency (Intis) and the applicable interest which was accrued has been made available in the appropriate special accounts.

Discussion

In 1987 the Peruvian wheat importing agency (Empresa Nacional de Comercializacion de Insumos - ENCI) deposited the Inti equivalent of \$12,667,000 into a special account for the purpose of programming the funds for projects mutually agreed upon by USAID/Peru and the Government of Peru (GOP). The \$12,667,000 represented partial net proceeds from the sales of wheat provided under the August 11, 1986, Public Law PL 480, Title I Agreement between USAID/Peru and the GOP.

The August 11, 1986 Sales Agreement requires that:

The total amount of the proceeds accruing to the importing country from the sale of commodities financed under this agreement, to be applied to the economic development purposes set forth in Part II of this agreement, shall be not less than the local currency equivalent of the dollar disbursement by the Government of the exporting country in connection with financing of the commodities (other than the ocean freight differential), provided, however, that the sales proceeds to be so applied shall be reduced by the currency use payment, if any, made by the Government of the importing country.

4/ The extra cost incurred by the Government of Peru for shipping the PL 480 commodities on U.S. carriers.

The MOU to the August 13, 1986 Sales Agreement says that:

The Sales proceeds to be deposited in the central Treasury account will be equal to the gross sales proceeds received less the actual commercial expenses incurred and paid by the Government of Peru Agency related to the importation and distribution of the commodities sold, such as ocean freight, insurance, port fees, etc., but shall not in any case be less than the FAS [cost at point of delivery to a ship] value of the commodities.

Based on ENCI reported gross sales proceeds of the Inti equivalent of \$26,280,000 and after deducting its reported expenses of \$2,806,860, the net proceeds to be deposited should have been \$23,473,000. Yet, ENCI had deposited only \$12,667,000, leaving \$10,806,000 undeposited at the conclusion of our audit in March 1988.

USAID/Peru was aware of the ENCI deposit shortfall and has taken appropriate action to ensure that the proper amount of local currency will be deposited into the special accounts.

Unless the local currency generated from the PL 480 Title I agreements is made available for developmental purposes, USAID/Peru is not achieving a major purpose of the activity - helping Peruvians help themselves toward a greater degree of self-reliance in using their agricultural productivity to combat hunger and malnutrition.

Management Comments

Management generally agreed with this finding, but did not believe the recommendation, as stated in the draft report, should require that future agreements not be signed until the required Intis are deposited. USAID/Peru stated that in view of "...the support that the Ministry of Economy and Finance is giving to resolve the problem of the sales proceeds deposits, the USAID believes that the problem will be resolved in due course, and there is no need to hold up signing of new Title I agreements in order to force resolution of the problem." Complete USAID/Peru comments on this finding are presented in Appendix 1.

Office of Inspector General Comments

Based on the action and further clarifying information presented in USAID/Peru's response to the draft report, we revised the finding and the recommendation.

4. Systematic Accounting, Record-Keeping, And Reporting Was Lacking

Neither USAID/Peru nor the Government of Peru's (GOP) implementing agencies had instituted and adhered to a program of systematic accounting for and reporting on the food importation and sales programs under Public Law (PL) 480 Title I and Section 416 agreements. Also the GOP had not submitted certified annual reports of the receipt and expenditure of PL 480 Title I sales proceeds as required by the agreements. The agreements further require systematic reporting by the host government implementing agencies, which implicitly requires systematic record-keeping. Reasons given by the USAID and host government officials were not entirely clear but seemed to be essentially an inability by USAID/Peru to convert, at least thus far, stated GOP commitments and willingness to improve systematic accounting and reporting into realities. As a result, USAID/Peru cannot know with a reasonable degree of certainty that the proceeds are actually deposited to the Special Account and subsequently disbursed to the mutually agreed upon projects, nor if the Title I activities are accomplishing their intended objectives.

Recommendation No. 4

We recommend that USAID/Peru:

- a. obtain from the Government of Peru the required certified reports on the receipt and expenditure of the sales proceeds and interest earned for the 1985, 1986 and 1987 sales agreements,
- b. determine precisely what reports are needed from the Government of Peru in order to effectively monitor the Public Law 480 Title I and Section 416 activities and formally advise the Government of Peru of these requirements,
- c. complete its preparation of a comprehensive Mission Order which states, as explicitly as possible, the duties to be performed by the Public Law 480 Title I program manager, and
- d. develop an action plan to improve the Government of Peru's ability to keep records and provide timely and accurate reports.

Discussion

USAID/Peru did not have clear and complete documentation regarding the importing, sales, and local currency deposits associated with Title I commodities made available for Fiscal Years 1985, 1986, and 1987. Nor did USAID/Peru have sufficient information available showing the actual and specific use of the Public Law (PL) 480 Title I sales proceeds beyond the programming/budget stage. It required a span of several weeks and the efforts of both Mission and audit staff to obtain information showing commodities received, commodities sold, sales proceeds, and deposits made to the special accounts.

The PL 480, Title I sales agreements for 1985, 1986, and 1987 required that the Government of Peru (GOP) provide at least "annually a report of the receipt and expenditure of the sales proceeds, certified by the appropriate audit authority of the Government of the importing country, and in the case of expenditures, the budget sector in which they were used."

The PL 480, Title I agreements for FY 1985, 1986, and 1987 also require the GOP to report on the arrival of each shipment of commodities. MOUs for fiscal years 1985, 1986, and 1987 require monthly and quarterly reporting on the programming and expenditure of the local currency sales proceeds. The Section 416 Agreements, signed in August 1986 and November 1987, require reports on the special accounts and the expenditure of the local currency sales proceeds.

-- The MOUs under the Section 416 Agreements further require that:

...Each month, the Banco de la Nacion will send the Special Account's bank statement to the Ministry of Economy and Finance and the Office of the USAID Controller for review and for the appropriate monthly reconciliation... In addition to the monthly bank statement, the Office of the Director General of the Public Treasury, who coordinates the collection and disbursement of these funds, will provide A.I.D. with a monthly statement of deposits to and disbursements from the Special Account on or before the 15th day of the following month.

Both the August 1986 and November 1987 Section 416 Agreements require that:

The Cooperating Sponsor shall maintain records and documents for a period of three years from the date of the export of the agricultural commodities in a manner which will accurately reflect all transactions pertaining to the receipt, storage, distribution, and sales of the agricultural commodities.

Although USAID/Peru had contracted an individual in September 1987 to expedite the required reports, none had been received by USAID/Peru from the responsible GOP entities at the close of the audit.

A.I.D. Handbook 9 Chapter 1 states that, "A.I.D. has the primary responsibility for the administration of the PL 480 program" and that Missions are responsible for:

- (a) Assisting host governments to develop and justify program proposals, and provide recommendations for approval/disapproval.

- (b) Monitoring host government performance under signed agreements particularly self-help activities and uses of generated local currencies.

The GOP's lack of adherence to reporting and record-keeping requirements was the result of USAID/Peru not enforcing the provisions of the agreements and convincing the GOP of the necessity of timely and accurate reporting. However, Mission officials conveyed informally to the GOP the importance of adhering to the reporting requirements.

There was no clear assurance that the PL 480 Title I sales proceeds were actually being disbursed to the mutually agreed upon projects and that those projects were achieving their intended objectives. At January 1988, over 790,000,000 Intis of the sales proceeds from the 1985 and 1986 agreements were in fact still unused by the GOP for approved programs. Furthermore, as reported in Finding No. 2, about 13,000,900 Intis (\$934,813) had been removed from the special accounts for unknown purposes.

While not a direct cause of ineffective record-keeping and reporting, it should also be noted that USAID/Peru did not have a Mission Order explicitly stating the duties and functions of the PL 480 Title I program manager. The current manager was only recently appointed to the position and had not received any formal training in the various aspects of the PL 480 Title I program. Without adequate training and a detailed Mission Order, a program manager is likely to experience difficulty and frustration in trying to track and oversee a complicated activity such as the PL 480 Title I program in Peru.

We have been advised that USAID/Peru is developing a Mission Order for its PL 480 Title I program. We believe that this Mission Order should be completed as soon as possible and that USAID/Peru should also consider providing formal training to the PL 480 program manager.

Management Comments

USAID/Peru generally agreed with this finding and the recommendation. It has now implemented or is implementing a number of steps to comply with the recommendation that includes receiving certified reports, issuing a Memorandum of Understanding for reporting requirements, and finalizing a Mission Order on managing food agreements. However, it did not agree with part b, which originally recommended that no future Public Law (PL) 480 Title I agreements be signed until the Government of Peru had met all its reporting requirements. Also, USAID/Peru did not agree with our statement that it did not have complete information available regarding the PL 480 Title I and Section 416 agreements since complete information was not available for the fiscal year 1987 program. The complete text of USAID/Peru's comments are attached as Appendix 1.

Office of Inspector General Comments

While USAID/Peru did acquire a significant amount of program information during the audit, it was not available at the outset of the audit nor was

it being systematically provided by the Government of Peru (GOP). Since USAID/Peru stated that it has reached agreement with GOP officials on reporting requirements, we have revised the recommendation. When the Memoranda of Understanding and the Mission Order referred to in the mission comments have been signed and a copy received by our office, recommendation No. 4 part b. and c. can be closed. Recommendation No. 4 part a. and d. are unresolved and will require USAID/Peru to provide documentation to address the issues.

B. Compliance and Internal Control

The extent of compliance and internal controls reviewed was limited to the issues in this report.

Compliance

The audit disclosed non-compliance with the sales agreements. The Government of Peru i) had not applied the Public Law 480 Title I sales proceeds to identifiable previously programmed self-help projects (Finding 1); ii) had withdrawn sales proceeds for unknown purposes (Finding 2); iii) had not deposited all required sales proceeds into the Special Accounts (Finding 3); and iv) had not provided required reports on the generation and use of sales proceeds (Finding 4).

Internal Control

Findings Nos. 1, 2 and 3 identified internal control deficiencies over the deposits and expenditures of sales proceeds. In addition, finding No. 4 reported that USAID/Peru had not received adequate reporting on the provision and application of Public Law 480 Title I proceeds in order to effectively know whether or not the program was having any significant impact on rural development.

C. Other Pertinent Matters

Public Law (PL) 480 Title I agreements permit the Government of Peru's (GOP) importing agencies to exclude the cost of ocean freight differential and currency use payments in determining the minimum amount of local currency to be deposited to the special accounts for expenditure on the mutually agreed upon projects. The MOUs further expanded the kinds of expenses which could be deducted. For example, the August 1986 Memoranda of Understanding (MOU) states that such costs as ocean freight, insurance, port fees, etc., could be deducted.

While USAID/Peru believes that these costs are reasonable and proper, we do not believe the MOUs should effectively supersede the original signed agreements in the matter of determining net available local currency proceeds. We believe USAID/Peru should incorporate directly into the PL 480 Title I agreements a definition of what constitutes net sales proceeds to be made available for projects. We have not made a formal recommendation because USAID/Peru has stated that the GOP was only deducting reasonable costs actually incurred.

Currency Use Payments - The 1985, 1986, and 1987 PL 480 Title I agreements required that the GOP repay five percent of the PL 480 loans in local currency. These repayments are called currency use payments (CUPs). They are in effect repayments on the dollar loans for the value of the PL 480 Title I commodities, that is, an equivalent amount is offset against the dollar repayment of the loan. The CUP program is used by the U.S. Embassy for local currency operating expenses and offset against its operating expense budget. The U.S. Embassy is responsible for collecting the CUPs.

The agreements as well as the United States Department of Agriculture's publication entitled "PL 480 Concessional Sales and Food for Development Programs - Terms and Conditions, Planning and Implementation Procedures" state that the CUPs be made "...no later than one year after the final disbursement by the Commodity Credit Corporation under this agreement, or the end of the supply period, whichever is later..." and that payments be applied to the dollar loan repayments and operating expense budget at the most favorable exchange rate not unlawful in Peru.

According to available records at the USAID/Peru, Embassy and the U.S. Department of Agriculture Attache's Offices in Peru no CUPs had been made by the GOP during the period June 1984 to December 1987, nearly three and a half years, and those that were made in December 1987 were applied at an exchange rate considerably less than the highest rates of exchange not unlawful in Peru.

Pursuant to this and other A.I.D. Inspector General audits of Title I programs in Latin America, the Department of State Inspector General had issued a report recommending several corrective actions to effectively manage the CUP collection.

We had presented this issue as a finding with recommendations to USAID/Peru in our draft report. Because the State Department Inspector General has made appropriate recommendations regarding CIP collection and management, the issue is presented in this final report as an other pertinent matter with the suggestion that USAID/Peru continue to extend its influence and assistance in obtaining the CIPs on time and at the most favorable exchange rate legally available.

AUDIT OF
USAID/PERU
PUBLIC LAW 480 TITLE I
AND SECTION 116 PROGRAM

PART III - APPENDICES

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

Memorandum



TO : Mr. Coinage H. Gothard, Jr., RIG/A/T
Tegucigalpa, Honduras

FROM : Donor M. Lion, Mission Director *DM*
USAID/Peru

SUBJECT: Draft Audit Report of USAID/Peru Public Law 480, Title I, and Agricultural Act of 1949, Section 416, Sugar Quota Offset, Programs: USAID/Peru Comments

1. This memo provides USAID/Peru's comments on the subject draft audit.

2. USAID/Peru believes that a correct analysis of the financial data supplied to the RIG auditors leads to completely different conclusions on some matters and revision or elimination of several recommendations. In one particular case, the recommendation should be dropped because other agencies, not the USAID, are responsible for its implementation, a fact known to the RIG auditors. Had accurate reference been made to the pertinent laws, executive orders and texts of agreements and had full use been made of materials supplied to the RIG auditors by the USAID, several misstatements of fact and other errors that appear in the draft audit would have been avoided. This memorandum provides information and analysis which indicate what revisions in the draft audit are required. Seventeen exhibits document and reinforce USAID's comments. The USAID requests that this paragraph appear in the executive summary of the audit report.

3. In implementing the two programs included in the audit, the USAID pays careful attention to the requirements set forth by the Congress, as found in the legislation; by the Washington agencies responsible for the programs, as found in the exact language of the agreements, as specified by these agencies, and which form the basis of program implementation; by Presidential delegations of authority; by instructions received for negotiating agreements; and lastly, by other guidance, to the extent that the legislation and language of the agreements require interpretation. There are a number of assertions of fact in the draft audit which are not in accord with the legislation or the language of the agreements, and which have lead in some cases to mistaken judgments and conclusions. These should be corrected. Some specific points are listed below, and others will be covered in comments on the specific audit recommendations.

A. Title I and Section 416 programs are authorized by completely different legislation, with completely different requirements. Thus, as shown in the subject of this memorandum, the Audit should clearly



21

state that it covers PL-480 Title I programs, and Agricultural Act of 1949, Section 416 Sugar Quota offset programs. The audit does not cover PL-480 Title II programs, and it does not cover Agricultural Act of 1949 Section 416 programs which are not carried out as part of the sugar quota offset programs. These latter programs are carried out by a different office in the USAID, which did not participate in the audit in any way, and are administered by different staffs in Washington. Exhibit A contains the text of Section 416(b) of the Agricultural Act of 1949.

B. PL-480 Title I does not consist solely of concessional sales on credit terms; since December 1985, it also includes sales for local currency under Section 108 of PL-480, although no Section 108 program has been implemented in Peru.

C. Section 416 is not limited to donations of commodities for sale by private voluntary organizations; it also includes donations to PVOs and government for direct distribution, and donations to governments for sales by the government - the sugar offset program which is the subject of the audit.

D. The use of sales proceeds from PL-480 Title I programs is set forth in Section 106 of PL-480 (Exhibit B) which states that they will be used for "economic development purposes". Exhibit C provides a recent opinion from the AID General Counsel which discusses in exact terms the permissible uses of PL-480 Title I sales proceeds. Section 106(b) does not require that sales proceeds be used for self-help purposes or "self-help initiatives", as is often stated in the draft audit. Self-help measures are in Section 109 of PL-480 (Exhibit D) and there is no requirement that they be financed by sales proceeds (although priority may be given to that use in programming sales proceeds). Section 416 does require that sales proceeds be used "consistently with providing food assistance to needy people," but Section 416 does not include any self-help measures.

E. AID has not been delegated primary responsibility for the administration of the PL-480 programs covered in the draft audit. In Executive Order 12220 (Exhibit E), the President has delegated Title I of PL-480 to the Secretary of Agriculture. AID, through a subdelegation from the Director of IDCA is responsible only for the "negotiating and entering into agreements with friendly countries" activity for Title I. The Agricultural Act of 1949, in Section 416, provides authority directly to the Secretary of Agriculture. The USAID understands that he has delegated some of his authority to AID, at least as concerns the negotiating and entering into agreements, but USDA retains primary responsibility for Section 416 programs. In practice, following the guidelines on PL-480 Title I programs in Chapter 2 of AID Handbook 9, the USAID takes primary responsibility for implementation of self-help measures, and uses of generated local currencies. This is done in collaboration with the Agricultural Attache and the Economic Section of the Embassy. These are the only monitoring and implementation responsibilities placed on the USAID for PL-480 Title I programs in Handbook 9.

22

F. PL-480 does not have three primary objectives, as stated in the draft audit, but six. As stated in Section 2 of PL-480 (Exhibit F) they include developing and expanding export markets for U.S. agricultural commodities, and promoting the foreign policy of the U.S., as well as those three mentioned in the draft audit, and the new objective from 1985 of encouraging private enterprise in developing countries. The audit should recognize that Department of Agriculture and Department of State efforts to use Title I programs to achieve the first two purposes of the law listed here are legitimate ones, and are factors that impact on the USAID in using the program for reaching its humanitarian and development objectives.

G. The draft audit has several references to "The Foreign Assistance Act of 1954" and "The Foreign Assistance Act." These are incorrect. There is no relationship between the Foreign Assistance Act under which AID carried out its other programs and PL-480 and the Agricultural Act of 1949. AID guidance on implementation of the FAA does not apply to Title I and Section 416. This is particularly true for AID guidance on exchange rate policies (Exhibit G). The current LAC guidance on exchange rate policy is explicit that it does not cover Title I agreements, because AID does not have the authority to set policy on exchange rates for Title I agreements. Since FAA legislation and guidance are not applicable to the programs which are the subject of the audit, the audit must avoid using terms related to the FAA as if they apply to Title I and Section 416.

4. In a number of places in the executive summary and in the audit itself, up to Section II-A on Findings and Recommendations, there are imprecise and ambiguous statements that do not indicate with clarity what the findings of the audit are. The USAID believes that greater precision in drafting would make the audit more useful to all readers and users.

A. The executive summary talks of \$87 million in sales proceeds from the 1985-1986 agreements, which could be taken to indicate the value of the commodities financed by the U.S. Government under Title I and the value of the commodities and freight provided in the Section 416 donation. Actual U.S. Government disbursements for these agreements were under \$50 million, significantly less than the value of sales proceeds cited.

B. The statement "the Government of Peru had not provided evidence that it had effectively used PL-480 Title I sales proceeds for mutually approved projects ..." is highly ambiguous. Does this mean it had not provided "any evidence" or that it had not provided "complete evidence covering all mutually approved projects"? USAID staff provided the RIG auditors with a number of reports from the GOP on disbursements to mutually approved projects that complied with the amounts agreed upon between the USAID and the GOP.

C. The summary should indicate that the USAID took steps to manage the program more effectively prior to the start of the audit. The draft audit is ambiguous on when these steps started.

23

D. The statement that "Public Law proceeds were not used for development purposes ..." is highly ambiguous and misleading. Does this mean "not any", or "not all"? Based on the GOP reports and other information provided by the USAID, and interviews with project managers, the draft audit recognizes that development projects received funds provided for in mutual agreements between the USAID and the GOP on uses of sales proceeds.

E. The Draft Audit refers to this USAID as "the Mission" and to all the U.S. Government agencies represented in Lima as "the U.S. Mission." The difference between "the Mission" and "the U.S. Mission" is explained only once, in a footnote in Part II-A-4 of the draft audit. We suggest that when referring to the USAID/Peru Mission, the audit should always refer to "the USAID" and when referring to the agencies represented in the "U.S. Mission" in Lima, it refer to them as "agencies," not as "offices"; the USAID has constituent "offices" in Lima, but the other agencies do not.

F. The draft audit converts intis of sale proceeds to dollars at the fixed exchange rate of 13.95 intis per dollar. Yet the audit notes that this was a time of rampant inflation and frequently changing exchange rates. While there is no ideal solution to conversion of inti values to dollar values during the period of the audit, the simple method chosen in the audit creates anomalous results, such as making the sales proceeds 75% greater than the value of the commodities supplied. The 13.95 rate was not the average official rate of exchange in effect during the audit period, contrary to the statment in the draft audit.

G. In Part I-A, Background, the listing of GOP agencies involved in Title I and 416 activities should indicate that ENCI and ECASA handle sales as well as imports; that the National Treasury is part of the Ministry of Economy and Finance; and that the General Budget Office of the Ministry of Economy and Finance negotiates the agreements on the use of sales proceeds for specific projects and authorizes the disbursement of local currency for the projects.

PART II-A - FINDINGS AND RECOMMENDATIONS

5. Part II-A-1. This section of the draft audit, except for some clarifying changes, and one significant change which will be discussed below, was presented to the USAID as "Record of Audit Finding (RAF) No. 7" just prior to the departure of the auditors from Lima. The USAID has responded to this RAF, but the reply did not arrive before the draft audit was issued by RIG/A/T. The USAID believes that this reply to RAF No. 7 (Exhibit H) provides a correct account of program implementation, and will lead to substantial revision of this section of the draft audit. The USAID reply makes the following principal points:

A. A correct analysis of uses of sales proceeds must take into account the amount and timing of disbursements made to development projects in accordance with the mutually agreed upon schedule for use of sales proceeds.

The RIG auditors received information on these disbursements, which are acknowledged in the audit, and they further acknowledge that the GOP advances funds for projects, for reimbursement later when sales proceeds are available. To conclude that "... the government had not used proceeds from the ... Title I and Section 416 sales agreements ..." and "the GOP had effectively impounded the PL-480 resources" is thus paradoxical, and contrary to the admitted facts. The paradox disappears if one considers that the GOP has a single unified account, of which the special subaccounts for sales proceeds and the subaccounts for disbursements to AID agreed upon projects form a part, and considers that from the overall account point of view, the sales proceeds are deposited and then used to reimburse the GOP for expenditures already made or are used to make further expenditures for the agreed upon project purposes. By focusing on the subaccount balances exclusively as totally separate accounts, and not considering the overall relationship between deposits and expenditures for mutually agreed upon projects in the unitary account, the draft audit arrives at erroneous conclusions.

B. In considering the effectiveness of maintenance of value provisions, one must consider when the sales proceeds are to be deposited in accordance with the agreement, for maintenance of value does not apply until the sales proceeds are generated and scheduled to be deposited; and also when the funds are spent for project purposes, for once spent, maintenance of value no longer applies. The RIG auditors were supplied with this information, and they present information in the audit on when deposits were made and when expenditures took place, but they choose to ignore this in their analysis, and hence derive inflated estimates of losses from a purported lack of maintenance of value provision. The USAID demonstrated that all 1985 sales proceeds and interest were disbursed for mutually agreed upon purposes by the end of 1986. In the case of the 1986 agreement, a detailed analysis shows that if expenditures had gone as planned, the loss of purchasing power of the sales proceeds would have been less than 3%. Because of some lags in expenditures, the actual loss of purchasing power will be around 5%. Judged by these results, reasonable maintenance of value system exists.

C. The Mission and the GOP do have a mechanism for expediting use of sales proceeds to support approved projects. In the recent (and in expected future) budget cycle, the Mission has analyzed project needs and notified the GOP of desired sales proceeds project allocations before the commodities have been shipped from the U.S. The allocations are finalized and included in the budget law about the time the commodities arrive. The new year arrives and the GOP starts expenditures, advancing its own funds, as is acknowledged in the audit, immediately and if necessary before the sales proceeds are deposited in the special accounts.

D. In addition to failing to take into account dates of expected deposits and dates of expenditures in calculating the effectiveness of maintenance of value measures, the draft audit overestimates the rate of inflation, and hence

25

the loss in value of sales proceeds. The draft audit uses an annual rate of inflation of 87% in 1986 and 1987 to September yet the actual rate of inflation for the consumer price index in Lima, which is one of the two price indices used to measure inflation in Peru, was only an average of 80% during the period. The rate of increase in the other index used to measure inflation in Peru, the wholesale price index, during the period was lower than the rate of increase in the consumer price index for Lima.

E. The Mission indicated in writing to the GOP that the method used by the GOP for maintenance of value would be satisfactory, prior to its implementation. (Attachment to Exhibit H.)

The new section added to Part II-A-1, after submission of the RAF, covers the auditors' review of 20 projects receiving sales proceeds, to determine if the flow of counterpart contributions had been satisfactory. This was done by interviews with project managers. There were two findings: 75% of the projects reported their original budget requests had been lowered by the GOP; 59% stated their projects had received less than the approved budget amounts, and thirteen project officials stated their projects had been delayed because of insufficient funds being provided. These findings are used to support a conclusion that many of the jointly budgeted projects were not being adequately funded (Office of Inspector General Comments, Part II-A-3 and Office of Inspector General Comments, Part II-A-4). The USAID does not believe the information presented supports the conclusions reached.

It is true that many project managers have their original budget requests cut. This is not done by the GOP, however, but by the USAID. The USAID reviews all original project requests to see if they are justified, how well they fit within AID priorities, and how project needs accord with estimated overall sales proceeds availabilities. When the USAID requests sales proceeds allocations for the projects it supports, it is not rubber stamping project managers' requests, but presenting a request that it is prepared to justify and stand behind. In negotiating the 1988 sales proceeds project budget with the GOP, the GOP did not cut any of the AID requests, but did request some increases. If initial allocations prove to be inadequate, project amounts are increased during the year through supplementary credits. The USAID cannot agree with a conclusion that adequate funding of projects requires approval of the original requests for budget amounts by project managers, regardless of the justification presented for the requested amounts.

To check the auditors' statements about delays in projects being caused by insufficient funds, copies of the statement in the draft audit were shown to the 10 AID project managers who cover almost all of the projects receiving sales proceeds counterpart. Only one was in agreement with auditors' findings, and only two were in partial agreement. While a few projects have undoubtedly suffered from delays in funding from sales proceeds, the vast majority have not, and the USAID believes that the auditors' conclusions based on their reported project manager interviews cannot be sustained.

6. Part II-A-2. The USAID does not believe that this section should be included in the final audit, since the USAID is not responsible for CUP payment collections. The USAID called to the attention of the RIG auditors the statement made by RIG/A/T in its Audit Report No. 1-250-88-09, dated January 22, 1988, which raised management issues regarding CUP collections in Guatemala, as follows:

"Subsequent to our draft report issuance, we were advised by the State Department Inspector General that the responsibility for CUP collection lies with the U.S. Embassy. Since this responsibility was outside of AID's authority, the matter was referred to the Department of State, and we will consider Recommendation No. 2(b) closed on issuance of the report."

This was discussed with RIG/A/T management at the exit conference, at the conference RIG/A/T agreed to refer the CUP observations to the State IG, and perhaps also to the Treasury and Agriculture IGs, since information the USAID had provided the RIG auditors indicated that the two Departments have some responsibility for CUP collections.

The USAID has an interest in CUP collections only to the extent that negotiating instructions for Title I agreements require that Title I arrearages be paid before new agreements can be signed. To expedite payments of these arrearages so that new agreements can be signed, the USAID has encouraged CUP payments by the GOP. In this connection the USAID provided to the RIG auditors cables received and sent by the U.S. Embassy in Lima concerning CUP (Exhibit I). These cables clearly establish the following facts:

A. Instructions on collections of CUP payments come from RAMC USDO regional offices of the Department of State. They are directed to the BMO in the Embassy.

B. The U.S. Embassy in Lima routes them to the Budget and Fiscal officer, and does not send copies to the USAID.

C. In midsummer, 1987, none of the posts in the LAC region with CUP payment provisions in its Title I agreements was up to date on CUP collections. The problem seemed to be a systems problem, not a Peru specific problem.

D. When CUP collections are made, the Embassy Budget and Fiscal Officer sends the required notification to the RAMC regional Department of State office. There is no USAID clearance on payment notifications.

In connection with ensuring that CUP payments were recorded as received in Washington, so that arrearages would not exist as a barrier to signing new

agreements, USAID officers have been informed that the Department of Agriculture is responsible for receiving CUP payments as well as other Title I loan payments, and receives information on CUP payments through the Financial Management Service of the Department of the Treasury.

The cables also answer the question raised by the RIG auditors on why CUP payments were being received more than one year after the final disbursement by the CCC. In the cables in the Exhibit RAMC orders collection of all unpaid CUP in no uncertain manner. We believe that RIG auditors should direct their questions to the Department of State.

It was based on this information provided to the RIG auditors, that the USAID suggested at the exit conference that the Treasury and Agriculture IGs, as well as the State Department IG, might be involved in examining CUP collection questions, as this is not a matter of AID program management.

Concerning the draft audit recommendation that the USAID advise the Budget and Fiscal officer in the U.S. Embassy that all CUP payments will be converted using "the most favorable not unlawful exchange rate available in Peru," the USAID cannot accept this recommendation for the following reasons:

A. As already noted, the USAID has no responsibility for CUP collections and is not authorized to advise the agencies responsible for them how to carry out their assignments.

B. The phrase used in the recommendation "the most favorable not unlawful exchange rate available in Peru" cannot be applied to PL-480 Title I transactions. This phrase is applied to LAC/AID activities under the Foreign Assistance Act, and as shown in Exhibit G on exchange rate guidance, specifically cannot be applied to PL-480 transactions.

C. Examination of the 1985 PL-480 Title I agreement signed with the GOP shows the exchange rate definitions that are applicable to CUP transactions (Exhibit J). This language was continued by reference in the 1986 agreement, and identical language has been included in the 1987 agreement. This language is provided by Washington agencies in the negotiating instructions sent to the U.S. Mission, and cannot be changed by the U.S. Mission. (In fact, this language has been standard in all Title I agreement worldwide for many years.) The USAID believes that the exchange rate used in determining the dollar value of CUP payments must be the one which has been agreed upon with the GOP in the signed agreements.

The definition of applicable exchange rate for CUP payments states: "a rate in effect on the date of payment by the importing country which is not less favorable to the Government of the exporting country than the highest exchange rate legally obtainable in the importing country and which is not less favorable to the Government of the exporting country than the highest exchange rate obtainable by any other nation ... If a unitary rate is not

88

maintained, the applicable rate will be the rate (as mutually agreed by the two Governments) that fulfills the requirement (above)".

In view of the complex definition of the exchange rate to be used for CUP payments, the USAID believes that the RIG auditors should secure from the competent General Counsel Office concerned an opinion on the proper application of this definition to the recent CUP payments in Peru, before reaching any conclusions on whether any losses were suffered in the recent payments.

(While absent a valid legal opinion on the application of the language in the Agreement to the recent CUP transactions in Peru, the USAID takes no position on whether or not there were "losses," it would note that the calculations of the "losses" in the draft audit are in error because they contain double counting. There is only one exchange of local currency against a dollar debt payment when a CUP payment is made, and not two as claimed in the draft audit. A "loss" can take place only when intis are credited against dollars at an incorrect exchange rate. Therefore, the "losses" shown in the draft audit are twice as large as they should be.)

7. Part II-A-3. The USAID does not believe that this section should be included in the final audit, since the USAID has provided information to the RIG auditors demonstrating that the I/.13.0 million removed from the special subaccounts, plus the amounts in the special subaccounts from the FY 1985 agreement, had been used for jointly agreed development projects by the end of 1986. In demonstrating this, it is not required to show actual transfer of funds from one subaccount to another subaccount, and then to accounts of approved projects, but only to demonstrate that actual disbursements to mutually approved projects, in amounts that do not exceed those approved by the USAID, are equal to or exceed the total amount of sales proceeds and interest that are available for programming to jointly agreed projects.

As shown in Exhibit K, which was attached to the USAID's reply to RAF No. 2, the required deposit of sales proceeds from the 1985 agreement, in accordance with the Memorandum of Understanding and the Agreement, was at least I/.344.3 million. Actual deposits of sales proceeds, as detailed in Exhibit K, were I/.348.5 million. Interest earned on the sales proceeds was I/.28.2 million, giving a total expenditure requirement on approved projects of I/.376.7 million. This interest to be used for projects included I/.7.0 million which were transferred from the special account, and form part of the I/.13.0 million referred to in this section of the draft audit.

A detailed GOP report (Exhibit L) on expenditures in 1986 for approved projects, in accordance with the detailed mutual agreement on amounts to be disbursed for each project, shows that I/.449.5 million was disbursed for the mutually approved projects. Of this amount, I/.39.3 million were spent from a special account from the FY 1983 Agreement amendment for disaster recuperation, leaving expenditures financed from the FY 1985 Agreement at I/.410.2 million.

Thus, actual disbursements in 1986 exceeded the amount to be programmed for disbursements by I/.410.2 million minus I/.376.7 million, equal to I/.33.4 million. Attribution of the additional I/.6.0 million taken from the special subaccount in the first part of 1987 to reimburse the GOP for the 1986 expenditures would lessen the excess expenditures to I/.27.4 million.

The USAID in response to RAF No. 4 had previously informed the RIG auditors that the transfers from the special subaccounts were required by Peruvian law--Law 24582 of December 12, 1986 and Supreme Decree 132-87 of May 29, 1987--and were made after issuance of the Supreme Decree for the new law (Exhibit M). However, both the GOP and the USAID recognize that once earned on the special subaccounts, interest must be programmed for mutually agreed projects, regardless of whether the law requires its transfer from the subaccount.

In monitoring the uses of sales proceeds for development projects, as provided for in the Title I Agreements and Minutes of Understanding, the USAID follows the guidance of PD-5 and the Agency's Supplemental Guidance on Programming Local Currency, 87 State 327494, to rely on the recipient country to do as much of the work of utilizing and accounting for the host country owned local currency as possible. The USAID concentrates on assuring itself that actual disbursements to approved projects equal or exceed the amounts of sales proceeds, interest and other maintenance of value payments, that must be programmed for these purposes. This policy has been highly successful. The GOP has disbursed funds to agreed projects before sales proceeds had been deposited, has proposed or agreed to supplementary credits for projects in amounts acceptable to the USAID even though these supplementary credits exceed the total amount available for programming, and has provided reports, that USAID checks show to be reliable, on actual disbursements to projects and sales proceeds and interest generations, that indicate that compliance has achieved or exceeded requirements on disbursing funds for agreed upon purposes on an overall basis.

8. Part II-A-4. The USAID agrees with the title of this section "The correct amount of commodity sales proceeds was not deposited into the special accounts," but does not believe that in view of the steps the Mission is taking in cooperation with the GOP to correct the situation, and the generally satisfactory record on providing sales proceeds for mutually agreed development projects, that the step of suspending signature of new PL-480 Title I Agreements is required to force the GOP to make the needed sales proceeds deposits in special accounts. There are a number of errors of fact and interpretation in this section of the draft audit that should be corrected.

As documented in Exhibit N, the official ENCI accounting and the USAID memo of comment show that ENCI deposited in the special account an amount slightly in excess of the equivalent of the FOB price of the wheat imported under the FY 1986 Agreement, but did not deposit the additional amount, required according to the Memorandum of Understanding for the FY 1986

20

Agreement, to bring the deposit in the special account to the total net sales proceeds from the wheat importation. The shortfall in the special account was I/.150,727,559, not the I/.175 million claimed in the draft audit, for which no supporting explanation is supplied. Also, contrary to the statement in the draft audit, ENCI did not deduct the value of the commodities in determining the net sales proceeds; rather, it deposited the F.C.B. value of the commodities in the special account rather than the net sales proceeds.

When the shortfall in the deposits became apparent shortly after the final deposits on the imports of commodities from the FY 1986 Agreement became due, the USAID notified officials in the Ministry of Economy and Finance, and after informal efforts to secure compliance were not successful, the Director General of the Public Treasury in the Ministry of Economy and Finance has taken steps to require compliance in strong terms. See Exhibit O, which also contains an extract from the 1988 budget law, requiring full deposit of sales proceeds as provided for in food aid agreements, and Title I agreements in particular. This was added at the initiative of the Director General of the Public Treasury to make clear the deposit requirements for sales proceeds from food aid agreements.

Taking into account the justified needs of AID supported projects in 1987, the USAID was able to reach agreement with the GOP for adequate amounts of sales proceeds to be disbursed to these projects. To the extent that projects did not receive sufficient funds in 1987, which happened in a few cases, the cause was not lack of available sales proceeds to be programmed, but rather of difficulties of documenting the uses of past counterpart disbursements before the Ministry of Economy and Finance would make new disbursements, and other questions over proper requests and documentation for disbursements of the funds allocated. The USAID intervenes actively to resolve these requests, but in some cases resolution is delayed. There is no supportable finding in the draft audit that failure to deposit sales proceeds in the special account hindered the financing of AID supported or other priority development projects for which the Mission had requested allocations of counterpart funds. In view of this fact, and the support that the Ministry of Economy and Finance is giving to resolve the problem of the sales proceeds deposits, the USAID believes that the problem will be resolved in due course, and there is no need to hold up signing of new Title I agreements in order to force resolution of the problem. This requirement of the recommendation should be deleted.

The draft audit emphasizes that ENCI deducted seven different types of "administrative costs" in arriving at the net sales proceeds to be deposited into the account. As shown in Exhibit N, these are "administrative costs" only in the broadest sense of the word "administrative," since the costs included grain inspection costs, banking charges for opening letters of credit, and interest charges on the working capital used during the wheat import. The total amount of these costs was 3.8 percent of the sales price of the wheat. Private sector firms which import commodities through ENCI must also pay these costs, and they informed the USAID that they were considered reasonable.

9. Part II-A-5. The USAID accepts the four recommendations on accounting, record keeping and reporting contained in this section, and has implemented or is implementing a number of steps to comply with the recommendations.

A. The USAID is taking steps to secure certified reports on the receipt and expenditure of sales proceeds for the 1985, 1986 and 1987 sales agreements. Since the utilization of sales proceeds for the 1985 Agreement is now completed, the USAID expects to receive these first. Final certified reports on the sales proceeds from the 1986 Agreement will be received shortly, but since expenditure of these proceeds will not be completed until early 1989, a final certified report will not be available until after that date.

B. The USAID has reviewed reporting requirements with the GOP agencies involved in preparing and presenting them, and has arrived at agreements on the reports required for effective monitoring. The Memoranda of Understanding for the 1987 Agreements are being amended to include the new reporting requirements, and they have been accepted for inclusion in the Memorandum of Understanding for any forthcoming food aid agreements. The USAID has obtained acceptable reports based on adequate and verifiable records for adequate monitoring. This has been done in a cooperative mode with the GOP and there was no need to threaten that no new Title I Agreements would be signed until the GOP maintained adequate records and provided adequate reports. This requirement of the recommendation should be deleted.

C. The USAID will finalize shortly its Mission Order on managing PL-480 Title I and Section 416 sugar quota offset Agreements, which is now in draft. The draft order is very explicit on program management responsibilities and assignments.

D. The Mission will consider providing technical assistance to the GOP as needed to improve its record keeping, reporting, and other responsibilities under the Title I Agreements. The previous USAID effort to provide assistance could not be implemented, since AID guidelines on paying salary supplements were interpreted as preventing payment to the GOP individual proposed for his extra work on securing preparation of more timely reports.

Several statements in the "Discussion" part of the section should be revised. While it is technically true that the USAID "did not have complete information regarding the importing, sales and local currency deposits associated with Title I commodities made available for Fiscal Years 1985, 1986 and 1987," the statement is highly misleading. The USAID had complete information for the 1985 and 1986 Agreements, but it did not have and could not have complete information for the 1987 Agreements at the time of audit, since the process of importation and payment for the commodities had not yet been completed at the time of the audit.

12

Also, the USAID had ample information available showing the actual use of the local currency beyond the programming/budget stage. Exhibit L, which was provided to the RIG auditors, presents that information for 1986 for use of FY 1985 Agreement sales proceeds. Exhibit P, also provided to the RIG auditors, presents an example from August 1987 of the memoranda sent to USAID project officers quarterly, reporting on actual disbursements to projects as compared to agreed amounts for the year, for each approved project. The most recent memorandum in this series, for the first quarter of 1988, was issued June 2, 1988. Semiannually, USAID project managers prepare project reports, which include reporting on counterpart receipts and uses by projects. These reports are reviewed by the USAID and by AID/W. When counterpart funds are not being received on a timely basis or in adequate amounts, and project impact is lessened because of this, these problems are identified at the reviews, and corrective steps taken. In recent semiannual reviews, problems with counterpart have been issues for only a few projects.

10. Part II-B. Compliance and Internal Control. The USAID believes that this section will require extensive revision, as it contains a number of statements from earlier in the draft audit which, as has been shown in this memorandum and the attached exhibits, are incorrect or unsustainable interpretations of the facts.

11. Part II-C. Other Pertinent Matters. The draft audit repeats a statement from RAF No. 8, which the Mission had attempted to correct in its response to the RAF (Exhibit Q). The ocean freight differential is deducted from the value of the financing provided by the U.S. Government before calculating the minimum amount of sales proceeds that must be deposited. The Agreement does not permit its deduction from the sales proceeds actually received when the commodities are sold. (In any case, the ocean freight differential is paid directly by the U.S. Department of Agriculture, and the USAID is never informed of the amount of the payment.)

Also, the deduction of CUP payments is not allowed from the sales proceeds before they are deposited in the special accounts. CUP payments are made by the Ministry of Economy and Finance, not by ENCI, and the sales proceeds must be deposited in the special account, in accordance with Peruvian law, before they can be used for payment of CUP.

Also, in Exhibit Q, the USAID points out that the definition of sales proceeds used in the Memoranda of Understanding for the 1986 and 1987 Title I Agreements conforms to the definition contained in instructions from Washington agencies for FY 1988 Title I Agreements--"proceeds net of costs paid by GOP (including freight) to get the commodity to point of sale and ready for sale." The instructions do not provide for defining sales proceeds in the text of the Title I Agreement. The USAID must follow Washington instructions on the text of the Title I Agreement, and has no discretion to include items in the text of the Title I Agreement outside of the specific requests contained in its instructions.

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33

LIST OF REPORT RECOMMENDATIONS

	<u>Page</u>
<u>Recommendation No. 1</u>	4
We recommend that USAID/Peru:	
a. provide evidence that the Government of Peru had expended sales proceeds generated under Public Law 480 Title I and Section 416 agreements for support to mutually agreed upon development projects,	
b. obtain from the Government of Peru evidence that effective maintenance-of-value measures have been implemented and funds currently on deposit be adjusted accordingly, and	
c. in conjunction with the Government of Peru, develop a mechanism to expedite the offsetting of actual Public Law 480 Title I and Section 416 local currency sales proceeds against reported expenditures for the mutually agreed upon projects.	
 <u>Recommendation No. 2</u>	 9
We recommend that USAID/Peru obtain relevant evidence that the equivalent of \$934,813 in local currency (Intis) has been redeposited into the special accounts and approved for use by the Mission.	
 <u>Recommendation No. 3</u>	 11
We recommend that USAID/Peru obtain relevant evidence from the Government of Peru that the equivalent of \$10,806,000 in local currency (Intis) and the applicable interest which was accrued has been made available in the appropriate special accounts.	

124

Recommendation No. 4

Page

13

We recommend that USAID/Peru:

- a. obtain from the Government of Peru the required certified reports on the receipt and expenditure of the sales proceeds and interest earned for the 1985, 1986 and 1987 sales agreements,
- b. determine precisely what reports are needed from the Government of Peru in order to effectively monitor the Public Law 480 Title I and Section 416 activities and formally advise the Government of Peru of these requirements,
- c. complete its preparation of a comprehensive Mission Order which states, as explicitly as possible, the duties to be performed by the Public Law 480 Title I program manager, and
- d. develop an action plan to improve the Government of Peru's ability to keep records and provide timely and accurate reports.

35

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