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AUDIT
OF USAID/BOLIVIA
ECONOMIC SUPPORT FUND PROGRAMS

AUDIT REPORT NO. 1-511-89-07
January 20, 1989

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OFFICE OF THE REGIONAL INSPECTOR GENERAL
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January 20, 1988

MEMORANDUM

TO : USAID/Bolivia Director, G. Reginald Van Raalte
FROM : RIG/A/T, *Constance N. Gothard*
Coinage N. Gothard, Jr.
SUBJECT: Audit of USAID/Bolivia Economic Support Fund Programs

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of USAID/Bolivia Economic Support Fund 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 to the report. The report contains four recommendations. Recommendation Nos. 1.c, 3, and 4 are resolved and will be closed when actions underway are completed. Recommendation Nos. 1.a, 1.b, 1.d., 1.e, 1.f, and 2 are unresolved. Please advise us within 30 days of any additional actions taken to implement recommendation Nos. 1.c, 3, and 4, and any further information you might want us to consider on the unresolved recommendations.

We appreciate the cooperation and courtesy extended to the auditors on this assignment.

EXECUTIVE SUMMARY

Economic Support Fund grants were provided to Bolivia in 1986 and 1987 to assist in its economic recovery through balance-of-payments support. A total of \$14.3 million was disbursed to the Government of Bolivia under these grants, and the Government had disbursed counterpart local currency equivalent to \$8.5 million to jointly programmed development projects. These counterpart local currency disbursements were required by the grant agreements as a condition of the dollar assistance. A third Economic Support Fund agreement was signed with the Government of Bolivia in July 1988 but was not covered by the audit since no disbursements had been made.

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a limited-scope financial and compliance audit of USAID/Bolivia's Economic Support Fund programs. The specific audit objectives were to assess compliance with applicable laws, regulations, policies, and agreements; evaluate the internal controls established by USAID/Bolivia, the Executive Secretariat, and the Project Coordination and Control Unit; and selectively evaluate the internal controls established by recipient agencies which used implemented local currency to development projects and activities.

USAID/Bolivia's Economic Support Fund programs have been affected by basic management problems since inception and, considering the limited benefits of the programs to date, our audit raises serious questions as to the need for the programs in their present form. None of the \$7.2 million provided under the 1987 program had been used and therefore had not had the intended impact on Bolivia's balance of payments. Also, the Government of Bolivia had failed to make required local currency deposits equivalent to \$5.7 million, while USAID/Bolivia had not effectively monitored program implementation. Internal control problems were also found in the Executive Secretariat and the Project Coordination and Control Unit in the areas of organization, staffing, planning, supervision, and accounting controls. Serious internal control problems (e.g., a lack of required books and records) were discovered in one of the recipient agencies visited during the audit, while relatively minor internal control problems were found in the second recipient agency.

USAID/Bolivia had a new top management team which was working to strengthen Economic Support Fund program management in light of recent guidance. In response to a recent audit and evaluation, the Mission planned to reorganize the Executive Secretariat and the Project Coordination and Control Unit. It also planned to establish a new implementation unit in the Ministry of Planning which would manage the local currency deposited under the 1987 and future programs. The Mission had also taken steps to fortify its own management of Economic Support Fund programs. For example, it issued an April 28, 1988 local order which established a local currency monitoring committee and assigned specific monitoring responsibilities to Mission offices. As another example, three financial analysts had been assigned exclusively to monitor local currency activities.

This report contains four findings. The first finding is that the benefits of the 1986 and 1987 programs were limited by problems which had not been fully reported to A.I.D./Washington. The second finding is that the dollar accounting procedures for the 1987 program did not comply with applicable guidance. The third finding is that no interest was earned on Economic Support Fund local currency, and no determination justifying this decision had been prepared. The fourth finding concerns USAID/Bolivia's management of a narcotics awareness trust fund activity which was not covered by its trust fund agreement with the Government of Bolivia. One other pertinent matter dealing with internal controls is also discussed in the report.

The benefits of the 1987 Economic Support Fund program were limited by slow expenditure of both dollars and local currency. In addition, both the 1986 and 1987 programs were affected by arrearages in local currency deposits. These conditions were contrary to Economic Support Fund agreements, operational letters, and generally accepted management principles. Due to the Government of Bolivia's limited administrative capacity along with limited monitoring by USAID/Bolivia, these deficiencies were not corrected and were not fully disclosed in certain documents sent to A.I.D./Washington. As a result, the planned benefits of the programs had not been fully achieved and A.I.D./Washington was not fully informed about problems affecting the programs. The report recommends that the need for Economic Support Fund programs in Bolivia and the Government of Bolivia's capability to manage these programs be reevaluated. It also recommends that USAID/Bolivia correct the problems affecting the 1986 and 1987 programs and revise its reporting on the status of these programs. USAID/Bolivia's comments provided detailed explanations for some of the problems experienced, and suggested that parts of the recommendation be deleted.

A.I.D. guidance implementing the 1987 continuing resolution required that, when dollars are used to reimburse import transactions, the reimbursements be part of a timely sequence for completing the transactions. In July 1988, USAID/Bolivia approved reimbursement of transactions which took place from August 31, 1987 forward. These new procedures were not in compliance with the guidance, since the reimbursements would not be part of a timely sequence. USAID/Bolivia approved these procedures in order to accelerate disbursement of the dollars from the separate account. If the new procedures are implemented, USAID/Bolivia will not be able to determine the actual use of \$7.2 million in Economic Support Fund dollars. The report recommends that USAID/Bolivia modify dollar accounting procedures. USAID/Bolivia believed that these procedures were already in compliance with applicable guidance.

A.I.D.'s supplemental guidance on programming local currency favors placing local currency in interest-bearing accounts, unless the highest A.I.D. official at post determines in writing that interest should not be earned. The Central Bank of Bolivia was offering certificates of deposit which provided maintenance of value relative to the U.S. dollar plus

interest, but USAID/Bolivia had not asked the Government of Bolivia to invest Economic Support Fund local currency in these certificates. No determination justifying a deviation from A.I.D.'s preference for interest-bearing accounts had been prepared. Rough calculations indicate that interest equivalent to about \$500,000 could be earned during the next year. USAID/Bolivia did not favor earning interest on Economic Support Fund local currency primarily because of the effect this could have on Bolivia's money supply. In our opinion, the interest earnings would not have a significant impact since they would increase Bolivia's money supply only about three-tenths of 1 percent. The report recommends that interest be earned on the local currency, or that a determination be prepared explaining why interest should not be earned. USAID/Bolivia officials did not favor earning interest because of concerns that this could significantly increase Bolivia's money supply.

A.I.D. regulations state that host government-owned local currency may only be managed by A.I.D. under a signed trust fund agreement. USAID/Bolivia had a trust fund agreement with the Government of Bolivia that covered local operating costs of the Mission. However, the Mission was also managing a narcotics awareness activity without proper authorization from the Government of Bolivia. This could lead to misunderstandings if the host government felt that these funds were not correctly used. USAID/Bolivia originally began managing narcotics awareness trust funds because of the sensitive nature of this activity. The Mission recognized that it had not complied with trust fund guidance but had experienced difficulty in identifying a qualified institution to manage this activity. The report recommends that USAID/Bolivia sign a trust fund amendment which authorizes the Mission to manage these funds or return the funds to the Government. USAID/Bolivia agreed with this finding and recommendation and had returned the funds to the Government of Bolivia. This recommendation will be closed when we receive documentation showing the transfer of funds.

Office of the Inspector General

AUDIT
OF USAID/BOLIVIA
ECONOMIC SUPPORT FUND PROGRAMS

TABLE OF CONTENTS

	<u>Page</u>
PART I - INTRODUCTION	1
A. Background	1
B. Audit Objectives and Scope	2
PART II - RESULTS OF AUDIT	4
A. Findings and Recommendations	5
1. Benefits of the 1986 and 1987 Programs Were Limited by Delays Which Were Not Reported to A.I.D./Washington	5
2. 1987 Dollar Accounting Procedures Were Faulty	10
3. Local Currency Should Earn Interest	13
4. USAID/Bolivia Had Not Completely Complied with Guidance on Trust Fund Management	16
B. Compliance and Internal Control	18
C. Other Pertinent Matters	20
PART III - APPENDICES	
1. Management Comments	
2. Report Recommendations	
3. Report Distribution	

AUDIT
OF USAID/BOLIVIA
ECONOMIC SUPPORT FUND PROGRAMS

PART I - INTRODUCTION

A. Background

Economic Support Funds are provided to friendly countries in order to support the national interests of the United States under special economic, political, or security conditions. The Government of Bolivia received two Economic Support Fund (ESF) grants in 1986 and 1987. A total of \$14.3 million was disbursed to the Government of Bolivia under these grants, and the Government had disbursed counterpart local currency equivalent to \$8.5 million to jointly programmed development projects. These counterpart local currency disbursements were required by the grant agreements as a condition of the dollar assistance. A third ESF grant agreement was signed on July 25, 1988 but was not covered by this audit since no disbursements had yet been made. The purpose of these grants was to assist Bolivia's economic recovery by providing balance-of-payments support.

Grant agreement No. 511-0570 was signed on June 6, 1986. The entire \$7.2 million obligated under this agreement was disbursed to the Government of Bolivia on July 3, 1986 to pay for private sector imports. Although the stringent dollar tracking procedures established in later years were not in force in 1986, U.S. and Bolivian trade statistics indicated that Bolivia imported about \$51 million worth of capital goods, raw materials, and intermediate goods for the private sector from July 3, 1986 through July 2, 1987. As of August 22, 1988 the Government of Bolivia had deposited the local currency equivalent of \$5,603,130 to a special account. Of this amount, the equivalent of \$5,581,028 had been disbursed to jointly programmed projects and activities by August 31, 1988.

Grant agreement No. 511-0593 was signed on August 31, 1987. The \$7.2 million obligated under this agreement had been disbursed to the Government of Bolivia, but none of the dollars had yet been used to finance private sector imports. As of August 22, 1988, the Government of Bolivia had deposited the local currency equivalent of \$3 million to a special account, of which the equivalent of \$2,956,000 had been disbursed from the special account for jointly programmed projects and activities.

Grant agreement No. 511-0595 was signed on July 25, 1988. Since the agreement had just been signed, no dollar or local currency disbursements had been made. Therefore, the audit did not cover this agreement.

The Government of Bolivia's Ministry of Planning and Coordination had primary responsibility for managing these ESF programs. Under the 1986 program, however, local currency disbursements and some monitoring functions were accomplished by the Public Law 480 (PL 480) Executive Secretariat and the Project Coordination and Control Unit (UCCP). (These two organizations were originally established to manage the local

currency component of PL 480 agreements.) Under the 1987 ESF program, disbursement and monitoring functions were accomplished directly by the Ministry of Planning. USAID/Bolivia managed the equivalent of \$1.4 million in operating expense trust funds under the 1986 and 1987 programs, as well as the equivalent of \$2.2 million in narcotics awareness trust funds under the 1986 program. (Trust funds belong to the host government but are managed by A.I.D. on the host government's behalf.)

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a limited-scope financial and compliance audit of USAID/Bolivia's ESF programs. The specific audit objectives were to assess compliance with applicable laws, regulations, policies, and agreements; evaluate the internal controls established by USAID/Bolivia, the Executive Secretariat, and the UCCP; and selectively evaluate the internal controls established by recipient agencies which used local currency to implement development projects and activities.

To accomplish these objectives, records such as agreements, correspondence, reports, and accounting records were reviewed. Cognizant officials in USAID/Bolivia, the Executive Secretariat, the UCCP, the Central Bank, and two recipient agencies were interviewed.

To evaluate compliance with applicable laws, regulations, policies, and agreements, tests were made to determine whether:

- conditions precedent to disbursement were met by the Government of Bolivia,
- dollar disbursements to the Government of Bolivia were made to separate bank accounts and not comingled with other funds,
- dollars were used by the Government of Bolivia for authorized purposes,
- local currency was deposited in a timely manner by the Government of Bolivia and used for authorized purposes, and
- ESF programs were managed in accordance with legal and policy guidance found primarily in the 1987 continuing resolution, A.I.D.'s amplified policy guidance on ESF cash transfers dated October 20, 1987, A.I.D.'s supplemental guidance on programming local currency dated October 21, 1987, and A.I.D. Handbook 19.

To evaluate internal controls, the audit included tests to determine whether:

- USAID/Bolivia had adequate documentation to support its local currency programming decisions,

- USAID/Bolivia performed adequate monitoring to provide reasonable assurance that dollars and local currency were used wisely and for intended purposes,
- the Executive Secretariat and the UCCP had implemented sound administrative controls (i.e., a rational organizational structure, adequate staffing, a planning system, and systems for monitoring the uses of local currency), and
- two agencies which received the equivalent of \$896,599 in local currency to implement development activities had implemented accounting controls over the receipt of funds, safeguarding of funds and other assets, disbursement of funds, and recording of transactions.

In addition, a local accounting firm had reviewed the accounting controls implemented by the Executive Secretariat and the UCCP, and the findings and recommendations in the accounting firm's report were considered as part of our audit.

The audit was conducted from March 7, 1988 through August 24, 1988 in La Paz, Bolivia. The audit covered the period from June 1986 through August 1988, including \$14.3 million in A.I.D. disbursements and the local currency equivalent of \$8.5 million in counterpart disbursements. The audit was made in accordance with generally accepted government auditing standards for financial and compliance audits.

AUDIT
OF USAID/BOLIVIA
ECONOMIC SUPPORT FUND PROGRAMS

PART II - RESULTS OF AUDIT

The 1986 and 1987 Economic Support Fund (ESF) programs were affected by basic management problems which limited the programs' benefits. None of the \$7.2 million given to the Government of Bolivia under the 1987 program had been used at the time of our audit, almost one year after the first A.I.D. disbursement. Another \$7.3 million was obligated in July 1988 and \$23.5 million had been requested for a planned 1989 program. We could not determine the disposition of the \$7.2 million provided in 1986 because separate accounting was not required. Also, the Government of Bolivia had not made required local currency deposits equivalent to \$5.7 million, dollar accounting procedures did not comply with A.I.D. policy guidance, interest was not earned on local currency deposits, and USAID/Bolivia's management of a narcotics awareness trust fund activity was not authorized by its trust fund agreement with the Government of Bolivia.

USAID/Bolivia had a new top management team which was working to strengthen ESF program management in light of recent guidance. In response to a recent audit and evaluation, the Mission planned to reorganize the Executive Secretariat and the Project Control and Coordination Unit (UCCP). It also planned to establish a new implementation unit in the Ministry of Planning which would manage the local currency deposited under the 1987 and future programs. The Mission had also taken steps to fortify its own management of ESF programs. For example, it issued an April 28, 1988 local order which established a local currency monitoring committee and assigned specific monitoring responsibilities to Mission offices. As another example, three financial analysts had been assigned exclusively to monitor local currency activities.

The audit also disclosed non-compliance with a 1986 memorandum of understanding, operational letters 1 and 4 for the 1987 program, and A.I.D. policy guidance. Several internal control weaknesses were found. The major internal control weakness in USAID/Bolivia was a lack of effective monitoring of the ESF programs. Internal control problems in the Executive Secretariat and the UCCP were found in the areas of organization, staffing, planning, supervision, and accounting controls. Serious internal control problems (e.g., a lack of required books and records) were discovered in one of the recipient agencies visited during the audit, while relatively minor internal control problems were found in the second recipient agency.

The report recommendations are that the Assistant Administrator for Latin America and the Caribbean reevaluate planned ESF programs for Bolivia, and that USAID/Bolivia take steps to improve the utilization of ESF dollars and local currency, correct certain reports sent to A.I.D./Washington, and bring other aspects of its ESF programs into compliance with applicable guidance.

A. Findings and Recommendations

1. Benefits of the 1986 and 1987 Programs Were Limited by Delays Which Were Not Reported to A.I.D./Washington

The benefits of the 1987 Economic Support Fund (ESF) program were limited by slow expenditure of both dollars and local currency. In addition, both the 1986 and 1987 programs were affected by arrearages in local currency deposits. These conditions were contrary to ESF agreements, operational letters, and generally accepted management principles. Due to the Government of Bolivia's limited administrative capacity along with limited monitoring by USAID/Bolivia, these deficiencies were not corrected and were not fully disclosed in certain documents sent to A.I.D./Washington. As a result, the planned benefits of the programs had not been fully achieved and A.I.D./Washington was not fully informed about problems affecting the programs.

Recommendation No. 1

We recommend that USAID/Bolivia:

- a. obtain from the Assistant Administrator for Latin America and the Caribbean a reevaluation of the need for the Bolivia Economic Support Fund Program and of the Government of Bolivia's management capacity to implement and manage an Economic Support Fund program;
- b. notify the Government of Bolivia that it will not approve any additional Economic Support Fund disbursements until the Government of Bolivia has used all of the Economic Support Fund dollars for agreed upon purposes, and has deposited the local currencies accruing from the 1986 and 1987 Economic Support Fund programs;
- c. obtain evidence that procedures for local currency disbursements under the 1988 program have been established which provide for disbursement of funds in accordance with the progress of each activity and liquidation of previous disbursements before additional disbursements are made;
- d. fix responsibility within the Mission for verifying that Economic Support Fund local currency deposits are made as agreed;
- e. submit to the Latin American and Caribbean Bureau a corrected 1990 annual budget submission table VI and a corrected program assistance approval document for the 1988 Economic Support Fund program; and
- f. consult with the Office of Legislative Affairs and the Latin American and Caribbean Bureau's Office of Development Programs, as appropriate, to determine whether or not the 1989 congressional presentation should also be corrected.

Discussion

The following sections describe the problems which affected the 1986 and 1987 ESF programs: delays in using the dollars provided under the 1987 program, slow disbursement of local currency under the 1987 program, arrearages in local currency deposits under both the 1986 and 1987 programs, and inaccurate reporting to A.I.D./Washington on the progress of these programs. These conditions were contrary to ESF agreements, operational letters, and generally accepted management principles.

1987 Dollars Not Used - As of August 1988, nearly 11 months after the first A.I.D. dollar disbursement, none of the \$7.2 million made available under the 1987 ESF agreement had been spent. In order to spend the dollars, the Government of Bolivia had to develop detailed procedures and sign agreements with Bolivian intermediate financial institutions. Responsible Central Bank personnel could not reasonably explain why this process had taken so long. However, the Central Bank was in a period of transition after a reorganization and the firing of several hundred employees. At the same time, the Central Bank was managing other lines of credit for private sector imports worth more than \$130 million, and it could be presumed that Bank staff accorded the \$7.2 million A.I.D. line of credit relatively low priority.

In an effort to accelerate disbursement of the dollars, USAID/Bolivia and the Government of Bolivia agreed in July 1988 that 1987 ESF dollars could be used to reimburse import transactions which took place since the signing of the agreement on August 31, 1987. As discussed in finding No. 2, we do not believe that the planned reimbursement procedures complied with A.I.D. policy guidance on tracking the use of ESF dollars.

Local Currency Not Disbursed - The equivalent of \$4.2 million in 1987 local currency remained unspent as of August 1988. Use of the 1987 local currency was slowed by delays in programming the local currency and delays in developing disbursement procedures. A third factor which contributed to the problem, the Government of Bolivia's inability to make required local currency deposits, is discussed in the section on page 7.

The 1987 local currency was not programmed for use until six months after the grant agreement was signed. Mission officials explained that they had permitted the Ministry of Planning and Coordination to take the lead role in programming the local currency for A.I.D. and other donor projects. Unfortunately, the responsible Subsecretary did not immediately focus on this task, and his efforts were hampered by a lack of sufficient staff.

The disbursement procedures for 1987 local currency were not formalized in an operational letter until April 1988, about seven months after the agreement was signed. Interestingly, one of the conditions precedent to the first disbursement required the Government to submit local currency disbursement procedures. However, the Government submitted, and

USAID/Bolivia accepted, only a one sentence statement that the local currency would "be employed to support development activities." This statement did not meet the condition precedent's intent of defining how disbursements would take place. The disbursement procedures finally formalized in April 1988 were also in need of refinement, but Mission officials were reluctant to change them since this could slow down the use of the 1987 local currency even further. We defer to the Mission's judgment on this matter but believe that improved procedures are needed for the 1988 program.

Local Currency Not Deposited - The Government of Bolivia had not deposited the equivalent of \$4.2 million in local currency required under the 1987 program and \$1.6 million in local currency deposits required under the 1986 program. The funds needed to make the 1987 deposits were not included in the Government of Bolivia's budget, and so the funds had to be approved through "fiscal credits" similar to supplemental appropriations in the United States. The required approval process had not been completed by the end of our audit in August 1988. Weak monitoring by USAID/Bolivia was a factor contributing to late deposits under both years' programs. Mission officials stated that USAID/Bolivia had received no reports and had exercised essentially no oversight over the financial status of the 1986 local currency program. The Mission's monitoring of deposits under the 1987 program was also faulty: the Mission informed us in writing on August 25, 1988 that all of the deposits required under the 1987 program had been made, when in fact the equivalent of \$4.2 million remained to be deposited. No Mission office had been specifically assigned responsibility for verifying that required deposits were actually made.

Inaccurate Mission Reporting - Mission reporting must be complete and accurate to permit properly informed decision making by A.I.D./Washington. However, the delays experienced under the 1986 and 1987 ESF programs were not accurately reflected in three documents sent to A.I.D. Washington.

The program assistance approval document (PAAD) for the 1988 program contained two important inaccuracies. First, in describing the status of the 1987 program, the PAAD stated that:

The [Government of Bolivia's] deposit of the local currency to the special account has been timely and in accordance with the schedule provided via operational letter.

In fact, of the \$3 million equivalent deposited by March 18, 1988, the date of the PAAD, \$1.3 million was deposited after the dates established in operational letter No. 1. The PAAD also stated that:

The Mission and the Ministry of Planning have completed a review of the proposed uses of the [1987] local currency and an operational letter has been issued giving A.I.D.'s agreement to these uses. The

Ministry of Planning has countersigned this letter also indicating his agreement to the uses. Disbursement of these funds has begun and will continue over [calendar year] 1988.

The operational letter referred to was operational letter No. 4, which programmed all 1987 local currency except the \$716,000 equivalent used for operating expense trust funds. Disbursement of the funds programmed through operational letter No. 4 did not begin until April 22, 1988, more than a month after the date of the PAAD. Based on this PAAD, A.I.D./Washington approved a new \$7.3 million ESF agreement for Bolivia which was signed on July 25, 1988.

Two other program approval and planning documents also contained inaccuracies. The 1989 congressional presentation stated that the 1987 dollars had been used for imports for the private sector, when in fact none of the dollars had been spent. The 1989 annual budget submission indicated that 1986 and 1987 local currency had been spent more rapidly than was actually the case.

USAID/Bolivia officials emphasized that these erroneous statements and figures were reported to A.I.D./Washington inadvertently, and we found no evidence that would suggest otherwise.

The problems discussed above limited the benefits of the ESF programs. Since the 1987 dollars had not been used, the 1987 program had not achieved one of its key objectives: financing imports for the Bolivian private sector. Delays in depositing and spending local currency meant that fewer resources than planned were available under both years' programs to finance development projects in Bolivia. Finally, readers of certain documents sent to A.I.D./Washington could believe that the 1986 and 1987 programs had progressed smoothly when in fact there had been lengthy delays.

In conclusion, the Government of Bolivia had been slow to make deposits and use the resources provided under the 1986 and 1987 ESF programs. These problems were to some extent obscured by inaccurate reporting to A.I.D./Washington. Planned ESF programs should be reevaluated in light of the Government of Bolivia's inability to make full use of the resources provided under prior years' programs, and USAID/Bolivia should take action to correct the problems experienced under the 1986 and 1987 programs and prevent their recurrence. It should also revise its reporting on the progress of prior years' programs.

Management Comments

USAID/Bolivia agreed that it could have more closely managed and monitored the 1986 and 1987 ESF programs but felt that the draft report did not discuss in sufficient detail the difficulties encountered in implementing the programs. The Mission also believed that parts a, b, e, and f of the recommendation should be deleted from the final report.

Office of Inspector General Comments

We continue to believe that all parts of recommendation No. 1 should be implemented. In our opinion, the justification for providing additional ESF assistance to the Government of Bolivia was questionable since the entire \$7.2 million provided in 1987 remained unused and the Government had not made the equivalent of \$5.7 million in required local currency deposits. In addition, inaccurate reports to A.I.D./Washington needed to be revised to permit informed decisions on ESF assistance to Bolivia. Our detailed response to USAID/Bolivia's comments is included in appendix 1.

2. 1987 Dollar Accounting Procedures Were Faulty

A.I.D. guidance implementing the 1987 continuing resolution required that, when dollars are used to reimburse import transactions, the reimbursements be part of a timely sequence for completing the transactions. In July 1988, USAID/Bolivia approved reimbursement of transactions which took place from August 31, 1987 forward. These new procedures were not in compliance with the guidance, since the reimbursements would not be part of a timely sequence. USAID/Bolivia approved these procedures in order to accelerate disbursement of the dollars from the separate account. If the new procedures are implemented, USAID/Bolivia will not be able to determine the actual use of \$7.2 million in ESF dollars.

Recommendation No. 2

We recommend that USAID/Bolivia modify the 1987 dollar accounting procedures to comply with A.I.D.'s amplified policy guidance on Economic Support Fund cash transfer assistance.

Discussion

The 1987 continuing resolution required that countries receiving ESF cash transfers over \$5 million establish separate accounts for ESF dollars. The purpose of this provision was to improve accountability and reduce the possibility of inappropriate use of the dollars. A.I.D.'s amplified policy guidance on ESF cash transfers, dated October 20, 1987, implemented this statutory provision. Besides requiring separate accounts, the guidance stated that where reimbursement of import transactions was contemplated:

Reimbursement must be for specific import transactions and should be part of a timely sequence for completing such transactions. This type of reimbursement is to be distinguished from ex post attribution made after release of dollars from the separate accounts, a procedure employed in some ESF countries.

In other words, procedures which allow the host country to finance imports and then seek A.I.D.'s approval of selected transactions are not permitted.

USAID/Bolivia and the Government of Bolivia originally agreed to disburse the dollars from project No. 511-0593 through bank letters of credit to finance new imports. These original procedures would have provided accountability for use of the dollars. However, due to poor management by the Central Bank no disbursements for imports had been made nearly a year after the first dollars were deposited into the separate account.

In an attempt to accelerate the use of the dollars, the Government of Bolivia proposed to use the dollars to reimburse selected import transactions made since the project agreement was signed on August 31,

1987. USAID/Bolivia approved this procedure through operational letter No. 7, dated July 26, 1988.

In our opinion, this new procedure was not in compliance with the intent of the continuing resolution or A.I.D. guidance because it would not permit the Mission to control the end use of ESF dollars. On paper the dollars would be associated with eligible transactions which occurred since August 31, 1987, but in practice the dollars would be used by the Government of Bolivia for any purpose it desired.

USAID/Bolivia approved these procedures in order to speed disbursement of the dollars from the special account. According to the controller, the regional legal advisor verbally approved the procedures. However, no written legal opinion was obtained. Also, the controller felt that similar procedures adopted under an ESF program in Uruguay provided a precedent for their use in Bolivia. We do not believe that this is a valid precedent since (1) Uruguay is a relatively advanced developing country with well-established standards of accountability and (2) alternative tracking procedures were not feasible in Uruguay. The policy guidance on ESF cash transfers explicitly authorizes "simplified and de minimus" tracking procedures in relatively advanced countries with well-established standards of accountability. In contrast to the Uruguay case, Bolivia did not have well-established standards of accountability, and alternative tracking procedures (issuing bank letters of credit for new imports) were feasible.

If the new procedures are implemented, USAID/Bolivia will not be able to account for the actual use of \$7.2 in ESF dollars made available under project No. 511-0593.

In summary, the intent of both the 1987 continuing resolution and A.I.D.'s policy guidance on ESF cash transfers was to improve accountability for the use of ESF dollars. The procedures approved through operational letter No. 7 involved selecting eligible import transactions which occurred since August 31, 1987, documenting the transactions, and reimbursing them with ESF dollars. In our view, these procedures offered no improvement in accountability over the attribution procedures followed in many countries prior to the passage of the 1987 continuing resolution. USAID/Bolivia should modify the procedures to bring them into compliance with applicable legal and policy guidance.

Management Comments

USAID/Bolivia noted that the Government of Bolivia did not maintain foreign exchange controls and stated that the absence of controls made it practically impossible to determine the end use of ESF dollars. The Mission also stated that A.I.D./Washington officials agreed that a reimbursement system was the most appropriate alternative for tracking the use of the dollars. Therefore, the Mission suggested that recommendation No. 2 be deleted from the report.

Office of Inspector General Comments

We continue to believe that recommendation No. 2 should be implemented. It is true that the Central Bank made dollars available through an auction system. However, the availability of auctioned dollars did not in any way preclude the disbursement of dollars through bank letters of credit, a procedure which would permit USAID/Bolivia to verify the use of ESF dollars. We reiterate that this procedure was the one originally agreed to, and note that the Ministry of Planning and Coordination informed the Mission in November 1988 that it planned to use the same procedure to disburse dollars under the 1988 ESF program. Therefore, we see no reason why this procedure should not be followed to provide accountability for dollars provided under the 1987 program.

3. Local Currency Should Earn Interest

A.I.D.'s supplemental guidance on programming local currency favors placing local currency in interest-bearing accounts, unless the highest A.I.D. official at post determines in writing that interest should not be earned. The Central Bank of Bolivia was offering certificates of deposit which provided maintenance of value relative to the U.S. dollar plus interest, but USAID/Bolivia had not asked the Government of Bolivia to invest ESF local currency in these certificates. No determination justifying a deviation from A.I.D.'s preference for interest-bearing accounts had been prepared. Rough calculations indicate that interest equivalent to about \$500,000 could be earned during the next year. USAID/Bolivia did not favor earning interest on ESF local currency primarily because of the effect this could have on Bolivia's money supply. In our opinion, the interest earnings would not have a significant impact since they would increase Bolivia's money supply only about three-tenths of 1 percent.

Recommendation No. 3

We recommend that USAID/Bolivia negotiate with the Government of Bolivia a program for earning interest on Economic Support Fund local currency or prepare a determination demonstrating why interest should not be earned.

Discussion

A.I.D.'s supplemental guidance on programming local currency, dated October 21, 1987, states that:

A.I.D. policy favors that local currency be placed into an interest-bearing account in a deposit-taking institution, with any interest earned programmed as if it were principal, so long as such accounts are permitted under host country law and regulation and do not undermine internationally-supported stabilization agreements and sound monetary policy. A determination not to follow A.I.D.'s preference for interest-bearing accounts may be made by the highest A.I.D. official at post. Copies of each determination shall be forwarded to the appropriate Regional Assistant Administrator and [the Bureau for Program and Policy Coordination].

At the time of our audit, the Central Bank of Bolivia's 30-day certificates of deposit provided maintenance of value relative to the U.S. dollar plus 13.5 percent annual interest. In other words, the purchaser would receive interest sufficient to offset the local currency's decline relative to the U.S. dollar, plus 13.5 percent annual interest. However, the Central Bank local currency accounts established under the 1986 and 1987 ESF agreements did not bear interest, although the 1987 account did provide maintenance of value vis-a-vis the U.S. dollar. No plans had been made to earn interest on the local currency to

be deposited under the 1988 ESF agreement, and no written determination not to follow A.I.D.'s preference for interest-bearing accounts had been prepared.

The amount of interest which could be earned depends on how much local currency is deposited but not required for immediate disbursing needs under each year's program. Our rough projection is that the equivalent of about \$500,000 could be earned during the next year. This interest would be jointly programmed for development purposes.

USAID/Bolivia did not favor earning interest on ESF local currency primarily because of the effect this could have on Bolivia's money supply. However, the Mission may have overestimated the magnitude of this effect. If the interest earned amounts to the equivalent of \$500,000 per year, Bolivia's money supply would increase only about three-tenths of 1 percent.

In conclusion, A.I.D. policy encouraged placing local currency in interest-bearing accounts to increase the amount of local currency available for development purposes. USAID/Bolivia had valid concerns about the wisdom of applying this policy to the ESF programs in Bolivia, but in our judgment, these concerns were not sufficiently convincing to justify a deviation from A.I.D.'s preference for interest-bearing accounts. USAID/Bolivia should reach agreement with the Government of Bolivia on a program for earning interest on ESF local currency or prepare a written determination demonstrating why earning interest would not be advisable.

Management Comments

USAID/Bolivia noted that the Central Bank's internal procedures did not permit interest to be paid on the local currency special accounts. The Mission further noted that as larger ESF programs are approved in the future, the amount of local currency on deposit at any one time could also rise. Accordingly, earning interest on local currency deposits could have a larger inflationary impact than we estimated. The Mission stated that it was preparing a determination on this issue.

Office of Inspector General Comments

The Chief of the Central Bank's Department of Public Sector Accounts confirmed to us that interest could not be paid on the local currency special accounts. As indicated in the finding, the local currency would have to be invested in Central Bank certificates of deposit in order to earn interest.

We agree that, if larger ESF programs are approved in the future, earning interest on local currency could have a significant inflationary impact. This will not necessarily be the case however. In order to increase

Bolivia's M1 money supply 1/ by 1 percent, the equivalent of \$1.9 million in interest would have to be earned annually. This in turn would require that the amount of local currency deposited but not needed for disbursing needs at any one time average \$14.1 million, an unlikely prospect in our judgment. It should also be pointed out that the Mission could elect to earn interest as long as the resulting inflationary impact is acceptable and discontinue this policy if and when the impact becomes significant.

This recommendation is resolved since USAID/Bolivia has the authority to determine whether or not interest should be earned on ESF local currency. The recommendation will be closed once the Mission prepares a determination based on realistic estimates of how much interest will likely be earned and how this would affect Bolivia's money supply.

1/ M1 consists of cash outside banks and checking accounts.

4. USAID/Bolivia Had Not Completely Complied with Guidance on Trust Fund Management

A.I.D. regulations state that host government-owned local currency may only be managed by A.I.D. under a signed trust fund agreement. USAID/Bolivia had a trust fund agreement with the Government of Bolivia that covered local operating costs of the Mission. However, the Mission was also managing a narcotics awareness activity without proper authorization from the Government of Bolivia. This could lead to misunderstandings if the host government felt that these funds were not correctly used. USAID/Bolivia originally began managing narcotics awareness trust funds because of the sensitive nature of this activity. The Mission recognized that it had not complied with trust fund guidance but had experienced difficulty in identifying a qualified institution to manage this activity.

Recommendation No. 4

We recommend that USAID/Bolivia negotiate and sign a trust fund agreement amendment authorizing the Mission to manage narcotics awareness funds on behalf of the Government of Bolivia or return these funds to the Government.

Discussion

A.I.D. Handbook 19, Section 5.H.1., states that trust funds are administered by an A.I.D. Mission according to the terms of a trust fund agreement with the host country. A.I.D.'s supplemental guidance on programming local currency, dated October 21, 1987, reiterates that A.I.D. may only manage host government-owned trust funds pursuant to a trust fund agreement signed with the host government. It also states that trust funds may be used to support discrete new projects and activities only with the approval of the appropriate Assistant Administrator.

USAID/Bolivia's trust fund agreement with the Government of Bolivia authorized the Mission to use the equivalent of up to \$1.4 million in Economic Support Fund (ESF) local currency for its local operating costs. However, the Mission was also managing host government-owned ESF local currency for a narcotics awareness activity. These funds were used to publicize aspects of the drug problem in Bolivia. As of March 8, 1988, the Mission had spent the equivalent of about \$482,000 for this purpose. Mission officials stated that they began managing the narcotics awareness activity because the Government of Bolivia did not want to be closely associated with an activity which could be controversial. They recognized that the Mission had not completely complied with A.I.D. guidance, but explained that they had not been able to identify a Bolivian organization which could capably manage the narcotics awareness activity.

USAID/Bolivia had fiduciary responsibility for the narcotics awareness ESF local currency it managed on behalf of the Government of Bolivia. Since it had no clear authority or guidance from the Government of

Bolivia on how these monies were to be used, misunderstandings could arise if the host government felt that these funds were not properly used or managed. The Mission should either return these funds to the Government of Bolivia or obtain approval from the Assistant Administrator for Latin America and the Caribbean and sign a trust fund amendment authorizing the Mission to manage narcotics awareness activities.

Management Comments

USAID/Bolivia agreed with this finding and recommendation, and had transferred the narcotics awareness trust funds to the Executive Secretariat.

Office of Inspector General Comments

Recommendation No. 4 is resolved and will be closed when we receive documentation demonstrating that the narcotics awareness trust funds were transferred to the Executive Secretariat.

B. Compliance and Internal Control

1. Compliance

The audit included a review of compliance with applicable laws, regulations, policies, and agreements. Specifically, tests were performed to determine whether:

- conditions precedent to disbursement were met by the Government of Bolivia,
- dollar disbursements to the Government of Bolivia were made to separate bank accounts and not commingled with other funds,
- dollars were used by the Government of Bolivia for authorized purposes,
- local currency was deposited in a timely manner by the Government of Bolivia and used for authorized purposes, and
- ESF programs were managed in accordance with legal and policy guidance found primarily in the 1987 continuing resolution, A.I.D.'s amplified policy guidance on ESF cash transfers dated October 20, 1987, A.I.D.'s supplemental guidance on programming local currency dated October 21, 1987, and A.I.D. Handbook 19.

These tests disclosed four compliance exceptions. First, the Government of Bolivia had not complied with local currency deposit schedules established in the 1986 memorandum of understanding and in operational letters 1 and 4 for the 1987 program (see finding No. 1). Second, the dollar accounting procedures approved for the 1987 program were not in compliance with A.I.D.'s amplified policy guidance on ESF cash transfers (see finding No. 2). Third, no interest was earned on ESF local currency, and USAID/Bolivia had not prepared a written determination justifying this decision which was required by A.I.D.'s supplemental guidance on programming local currency (see finding No. 3). Finally, USAID/Bolivia was managing a narcotics awareness trust fund activity which was not covered by its trust fund agreement with the Government of Bolivia. USAID/Bolivia's management of this activity was not in compliance with the supplemental guidance on programming local currency, which stipulated that program trust funds could only be managed pursuant to a trust fund agreement (see finding No. 4). Other than the conditions cited, tested items were in compliance, and nothing came to our attention which would indicate that untested items were not in compliance with applicable laws and regulations.

2. Internal Control

To evaluate internal controls, the audit included tests to determine whether:

- USAID/Bolivia had adequate documentation to support its local currency programming decisions,

- USAID/Bolivia performed adequate monitoring to provide reasonable assurance that dollars and local currency were used wisely and for intended purposes.
- the Executive Secretariat and the UCCP had implemented sound administrative controls (i.e., a rational organizational structure, adequate staffing, a planning system, and systems for monitoring the uses of local currency), and
- two agencies which received the equivalent of \$896,599 in local currency to implement development activities had implemented accounting controls over the receipt of funds, safeguarding of funds and other assets, disbursement of funds, and recording of transactions.

In addition, a local accounting firm had reviewed the accounting controls implemented by the Executive Secretariat and the UCCP, and the findings and recommendations in the accounting firm's report were considered as part of our audit.

Internal control weaknesses existed in USAID/Bolivia, the Executive Secretariat, the UCCP, and the two recipient agencies covered by the audit. The major internal control weakness in USAID/Bolivia was a lack of effective monitoring of ESF programs (see finding No. 1). Internal control problems in the Executive Secretariat and the UCCP were found in the areas of organization, staffing, planning, and supervision. Also, a local accounting firm had expressed a negative opinion on the UCCP's financial statements as of June 30, 1987. Serious internal control problems (e.g., a lack of required books and records) were found in one of the recipient agencies visited during the audit, while minor internal control problems were found in the second recipient agency (see following report section).

C. Other Pertinent Matters

The review of host country internal controls was accomplished in conjunction with an audit of USAID/Bolivia's Public Law 480 (PL 480) programs. The internal control problems found had a greater effect on the PL 480 programs because more resources were involved, and for this reason the results of the internal control review are discussed in our forthcoming report on USAID/Bolivia's PL 480 programs. To briefly summarize the results of the review, internal control weaknesses in the Executive Secretariat and the Project Coordination and Control Unit (UCCP) existed in the areas of organization, staffing, planning, and supervision. Also, a local accounting firm concluded that the UCCP's financial statement as of June 30, 1987 did not reasonably present, in accordance with generally accepted accounting principles, the financial status of the programs managed by the UCCP and the Executive Secretariat. The accounting firm expressed this opinion because (1) the financial statement was not based on the UCCP's accounting records, (2) the UCCP's accounting records and financial statement were not in accordance with generally accepted accounting principles, and (3) serious internal control deficiencies in the Executive Secretariat and the UCCP prevented the auditors from completing their examination in accordance with generally accepted auditing standards. This meant that the UCCP could not adequately account for approximately \$95 million in PL 480 and ESF local currency. Serious internal controls weaknesses (e.g., the lack of required books and records) were found in one of the agencies which received ESF local currency, while minor weaknesses were found in the second recipient agency visited during the audit. Readers interested in additional details should refer to our forthcoming audit report on USAID/Bolivia's PL 480 programs.

AUDIT
OF USAID/BOLIVIA
ECONOMIC SUPPORT FUND PROGRAMS

PART III - APPENDICES

MANAGEMENT COMMENTS

This appendix includes a verbatim transcript of USAID/Bolivia's December 12, 1988 comments on our draft report, as well as our response to the points raised by the Mission.

MANAGEMENT COMMENTS

This memo constitutes USAID/B's formal response to subject draft audit report. Mission comments are provided for each section in the report as follows:

Executive Summary

The Executive Summary, as presently written, does not, in our opinion, accurately summarize the status of the two ESF programs and, for the person who reads only the Executive Summary, is extremely misleading. The entire summary should be rewritten to explain how the 1986 and 1987 programs were managed and correct some of the statements that lead the reader to the conclusion that "USAID/Bolivia had not effectively monitored program implementation." In this regard, the Mission wishes to point out that the Agency's first attempt to promulgate guidance for the management of local currency programs was released in October 1987. Thus, the 1986 program was managed without the benefit of that guidance and the 1987 program, signed in July, 1987, began before issuance of the guidance.

Once the guidance was issued, however, the Mission effected several major changes in its approach to how local currency would be managed, which are discussed in various sections of this response. The IG cannot reasonably expect these changes to take place overnight and progressive improvements were made in the management of these programs. The Executive Summary makes minimal reference to those changes and makes no reference as to how effectively the Mission responded to that guidance.

OFFICE OF INSPECTOR GENERAL (OIG) COMMENTS

Our audit ended in August 1988, ten months after the October 1987 guidance on local currency was issued. (This was not, incidentally, the first Agency guidance on management of local currency programs.) The Executive Summary describes the management improvements made by USAID/Bolivia since this guidance was issued.

22

MANAGEMENT COMMENTS

With reference to other parts of the Executive Summary, we have the following comment:

Page ii [now page i] says that the \$7.2 million of the 1987 program had no impact on the balance of payments because no disbursements of the dollars had been made. We agree that the Central Bank delayed for nine months in establishing the dollar disbursement and tracking system, but we cannot agree these dollars had "no impact on balance of payments." These resources, maintained in the separate account, served as an important resource for the GOB and were counted as net international reserves by the IMF. This is important to note as the IMF required the increase in foreign exchange reserves as an integral part of its standby agreement.

OIG COMMENTS

We have changed this passage in the final report to read: "None of the \$7.2 million provided under the 1987 program had been used and therefore had not had the intended impact on Bolivia's balance of payments." If in fact the \$7.2 million maintained in the separate account increased the Government of Bolivia's creditworthiness in the eyes of potential lenders and enabled the Government to borrow foreign exchange it could not have otherwise borrowed, then the ESF dollars helped reduce Bolivia's balance of payments deficit. However, the purpose of providing ESF dollars to the Government of Bolivia was to finance private sector imports, not to facilitate additional borrowing.

MANAGEMENT COMMENTS

Part I - Introduction

A. Background

We have no comments in this section.

B. Audit Objectives and Scope

The second paragraph states that "The local currency deposited under the 1986 ESF program had been reviewed by a local accounting firm" We presume your report is referring to the Telleria audit report and, if so, it should be clarified that the main purpose of the Telleria report was to audit the resources generated from the PL 480 program, not the ESF local currencies. Telleria reviewed the ESF local currencies only because these funds were under the fiscal responsibility of the Executive Secretariat. This distinction should be made in the final report.

. 23'

OIG COMMENTS

The accounting firm audited all of the funds managed by the Executive Secretariat and the Program Coordination and Control Unit (UCCP). These funds included PL 480 local currency, ESF local currency, and funds provided under USAID/Bolivia's Disaster Recovery Project (No. 511-0570).

MANAGEMENT COMMENTS

Part II - Results of Audit

The Mission cannot accept pages five and six [now page four] of the report as presently written. This section distorts the facts concerning the 1986 and 1987 ESF program and how they were implemented, monitored and controlled. The following are our specific comments regarding these two pages:

(a) First paragraph:

1. \$28 million has not been "requested," but rather the Agency originally earmarked \$25 million in the 1989 Congressional Presentation for Bolivia's ESF program. The Foreign Assistance Act as amended has changed this original earmarking to distribute \$61 million between the four narcotics countries i.e. Bolivia, Peru, Ecuador and Jamaica. The Mission has presented its PAAD at a \$23.5 million level, and a Bureau DAEC meeting on the PAAD was held on November 10, approving this level.

OIG COMMENTS

In its 1990 annual budget submission (dated May 1988) USAID/Bolivia proposed to obligate \$28 million for a 1989 ESF program entitled "Economic Recovery." We have modified our report to reflect the new planned level of assistance which was approved on November 10, 1988, after our audit ended.

MANAGEMENT COMMENTS

2. The last sentence is incorrect if it applies to the 1986 program. This sentence indicates the Mission did not follow Agency policy guidance when, in fact, AID policy guidance was only released in October 1987 and the dollars and local currency for the 1986 program began to be generated fifteen months prior to the guidance. The IG should rewrite this entire paragraph.

OIG COMMENTS

The sentence referred to reads:

Also, the Government of Bolivia had not made required local currency deposits equivalent to \$5.7 million, dollar accounting

procedures did not comply with A.I.D. policy guidance, interest was not earned on local currency deposits, and USAID/Bolivia's management of a narcotics awareness trust fund activity was not authorized by its trust fund agreement with the Government of Bolivia.

Taking each point in turn, the shortfall in local currency deposits affected both the 1986 and 1987 programs. These deposits were required by agreements dated June 6, 1986 and August 31, 1987, and these requirements were not changed by the issuance of new policy guidance in October 1987.

The dollar accounting procedures which did not comply with A.I.D. policy guidance were those approved under the 1987 program. The original 1987 dollar accounting procedures were approved by USAID/Bolivia on September 25, 1987. These original procedures were in compliance with guidance issued on October 20, 1987. However, modified dollar accounting procedures approved by USAID/Bolivia on July 26, 1988 were not in compliance with the October 1987 guidance.

No interest was earned on the local currency deposited under either the 1986 or 1987 ESF programs. New guidance issued on October 21, 1987 established a preference for earning interest on local currency but permitted Missions not to follow this policy if a determination was made in writing and forwarded to A.I.D./Washington. By the time our audit ended on August 24, 1988, USAID/Bolivia had neither complied with this policy nor prepared a determination justifying a decision not to follow A.I.D.'s preference for earning interest on local currency.

The narcotics awareness trust fund activity was financed with 1986 ESF local currency. Section 5H.1 of A.I.D. Handbook 19, dated July 31, 1985, required Missions to sign trust fund agreements when they managed funds owned by host governments. New guidance issued on October 21, 1987 reiterated this requirement. As of August 24, 1988, USAID/Bolivia had not complied with the requirement to manage host government funds only pursuant to a signed trust fund agreement.

MANAGEMENT COMMENTS

(b) Second paragraph:

As currently written, this paragraph indicates that your auditors have not fully understood how the 1986 and 1987 ESF funds were managed. The Mission did not initiate a reorganization of the PL 480 Executive Secretariat (ES) and UCCP for management deficiencies pertaining to ESF funds. The reorganization was planned for because of management deficiencies by the ES and UCCP in their management of PL 480 funds. The need for the reorganization was planned long before this audit started.

25

OIG COMMENTS

The Mission's assertion that the auditors did not understand how ESF funds were managed is unsupported. The paragraph from our draft report cited by the Mission read as follows:

USAID/Bolivia had a new top management team which was working to strengthen ESF program management in light of recent guidance. In response to a recent financial review and evaluation, the Mission planned to reorganize the Executive Secretariat and the Project Control and Coordination Unit (UCCP). It also planned to establish a new implementation unit in the Ministry of Planning which would manage the local currency deposited under the 1987 and future programs. The Mission had also taken steps to fortify its own management of ESF programs. For example, it issued an April 28, 1988 local order which established a local currency monitoring committee and assigned specific monitoring responsibilities to Mission offices.

This paragraph is not in any way inconsistent with the information provided in the Mission's comments.

MANAGEMENT COMMENTS

The report should reflect the fact the Mission, in 1986, decided to channel ESF resources through PL 480 mainly as a matter of convenience. In retrospect it may have been advisable to use other mechanisms, which were examined and reviewed.

OIG COMMENTS

The relevance of this information is not apparent to us.

MANAGEMENT COMMENTS

It should also be added in this paragraph that other steps have been taken by the Mission to fortify its monitoring, in addition to the issuance of a local order mentioned in the report. For instance, three financial analysts in the Controller's Office have been added to work exclusively on local currency programs (PL 480 and ESF) and a new Mission manual is being prepared providing Mission guidance in monitoring of local currency.

OIG COMMENTS

We have modified our report to reflect the assignment of three financial analysts to work exclusively on local currency programs.

26

MANAGEMENT COMMENTS

A. Findings and Recommendations

Recommendation No. 1 [Now Recommendation 1.a.]

"We recommend that the Assistant Administrator, Bureau for Latin America and the Caribbean, revalidate the need for the Bolivia Economic Support Fund program and reevaluate the Government of Bolivia's management capacity to implement and manage an Economic Support Fund program."

Response

We agree that the 1986 and 1987 programs could have had closer management and monitoring by the Mission; but this is understandable due to three major factors. First, the 1986 agreement was the first Balance of Payment support program that the Mission had to implement. Second, no comprehensive Agency guidance had been issued by 1986 providing the basic parameters for implementing and monitoring these types of programs (although no deficiencies are noted in the report for the 1986 program).

OIG COMMENTS

Our report describes two deficiencies relating to the 1986 program. First, the Government of Bolivia had not made the equivalent of \$1.6 million in local currency deposits required by the program agreement dated June 6, 1986. The requirement for local currency deposits was not affected by the issuance of new Agency guidance in October 1987. Second, the October 1987 guidance established a preference for earning interest on local currency but permitted deviations from this policy that were justified in writing. When our audit ended ten months after the guidance was issued, USAID/Bolivia had neither elected to earn interest nor prepared a justification for not earning interest on the 1986 local currency.

MANAGEMENT COMMENTS

Third, at the time the 1987 program was signed, the U.S. Congress had not passed legislation that required separate dollar accounts and the resultant tracking system for these types of programs,...

OIG COMMENTS

Actually, the requirement for separate ESF dollar accounts included in the 1987 continuing resolution became effective February 1, 1987. The 1987 ESF agreement was signed by USAID/Bolivia seven months later, on August 31, 1987.

MANAGEMENT COMMENTS

...nor had guidance been issued regarding the management of special accounts. As a result, the Mission initiated the program using guidance applicable at the time.

OIG COMMENTS

The original 1987 dollar tracking procedures approved by USAID/Bolivia on September 25, 1987 were in accordance with the 1987 continuing resolution and would have provided accountability for the use of the dollars if they had been implemented.

MANAGEMENT COMMENTS

Subsequently, it was necessary to modify these procedures in order to apply the new guidance and there were problems associated with coordinating these programs with the GOB and, as a result, understandable deficiencies in management occurred.

OIG COMMENTS

If the original procedures had been implemented, the Mission would have complied with both the 1987 continuing resolution and the Agency guidance issued on October 20, 1987. However, the Mission approved new procedures on July 26, 1988 in an effort to accelerate use of the dollars in the separate account. These new procedures were not in compliance with either the 1987 continuing resolution or the October 1987 guidance.

MANAGEMENT COMMENTS

This, however, does not mean that the GOB does not have the management capacity to implement and manage the ESF programs. As mentioned earlier, the Mission and the GOB are taking corrective action to assure that the management of these programs fits new AID guidance. A separate management unit with a highly qualified staff in the Ministry of Planning and Coordination has been established with the purpose of coordinating, implementing and monitoring not only the local currency generations, but also the use of dollars.

As a result of these and other actions, we do not believe your recommendation is valid and it should be deleted from the final report. For your information, the LAC Bureau has been aware of these problems since the 1988 PAAD was reviewed in March. The Bureau has not felt it necessary to reevaluate the GOB "management capacity" and has approved the 1989 PAAD at a \$23.5 million level.

28

OIG COMMENTS

We believe that the Assistant Administrator needs to reexamine the Government of Bolivia's management capability because serious implementation problems limited the benefits of the 1986 and 1987 ESF programs and because these problems were obscured by inaccurate reporting by USAID/Bolivia. To cite one example of inaccurate reporting, the 1988 Program Assistance Approval Document cited in the Mission's comments stated that the 1987 local currency had been deposited according to schedule when in fact it was not, and stated that local currency disbursements to projects had begun when in fact they had not.

MANAGEMENT COMMENTS

Recommendation No. 2 [now Recommendation No. 1]

"We recommend that USAID/Bolivia:

- "a. [now 1.b] notify the Government of Bolivia that it will not approve any additional Economic Support Fund disbursements until the Government of Bolivia has used all of the Economic Support Fund dollars for agreed upon purposes, and has deposited the local currencies accruing from the 1986 and 1987 Economic Support Fund programs;
- "b. [now 1.c] obtain evidence that procedures for local currency disbursements under the 1988 program have been established which provide for disbursement of funds in accordance with the progress of each activity and liquidation of previous disbursements before additional disbursements are made;
- "c. [now 1.d] fix responsibility within the Mission for verifying that Economic Support Fund local currency deposits are made as agreed;
- "d. [now 1.e] submit to the Latin American and Caribbean Bureau a corrected 1990 annual budget submission table VI and a corrected program assistance approval document for the 1988 Economic Support Fund program; and
- "e. [now 1.f] consult with the Office of Legislative Affairs and the Latin American and Caribbean Bureau's Office of Development Programs, as appropriate, to determine whether or not the 1989 Congressional Presentation should also be corrected."

Response

As stated above, the Mission has dedicated much time and effort to correct the known management deficiencies of the 1986 and 1987 programs. We believe that these efforts will result in greatly facilitated

implementation of the 1988 and future year programs. At this point, however, we feel it is important to set forth the difficulties encountered in implementing the 1986 and 1987 programs. Many of these problems were discussed with your staff, but are not reflected in the report.

The 1986 program was a straight balance of payment program with no restrictions for separate dollar accounts and tracking systems. When the dollars were disbursed, the GOB made the local currency available on an "as needed" basis in order to minimize any inflationary impact and provide for exchange rate movement. The 1987 program and its separate account/tracking system threw a "monkey-wrench" into the whole process. The GOB's foreign exchange allocation mechanism is one based on an open, free exchange system, without controls on dollar allocation. This means that any person or institution (including commercial banks) can buy foreign exchange through what is called the "bolsin," in effect, an open market, as long as the equivalent in local currency is deposited. Beyond that, the Central Bank (CB) exercises no control. The dollars can be used for any purpose the buyer of the foreign exchange desires. Because of this, the creation of a tracking system is practically impossible, and the CB does not feel that changes in its open foreign exchange allocation system which the Agency, World Bank and International Monetary Fund applaud, should be made to accommodate an AID tracking requirement. We might add that the Bureau does not share your interpretation of this requirement.

OIG COMMENTS

We do not agree that creation of a dollar tracking system is "practically impossible." We note that, as of May 31, 1988, the Central Bank had successfully disbursed more than \$65 million under other lines of credit for private sector imports. We also note that the Ministry of Planning has proposed to disburse the 1988 ESF dollars using bank letters of credit, the same procedure originally approved under the 1987 program and one which should provide accountability for the use of the 1988 dollars.

MANAGEMENT COMMENTS

Furthermore, IMF, World Bank, and AID Economic policy dialogue favors free and open foreign exchange markets in Bolivia and in most other countries. A tracking system for foreign exchange, which implies exchange controls, therefore, runs contrary to the USG's policy dialogue objectives.

Originally, the CB proposed a tracking system that would use the dollars for a new line of credit established in the Bank. However, the CB did not issue the regulations for this line of credit until June 1988.

110

As a result of the continuing dialogue between the Mission and CB regarding the use of the dollars in the separate account, the CB and AID agreed to use a reimbursement system that would permit the Separate Account to reimburse other GOB dollar accounts for eligible private sector imports after the signing of the Agreement. The LAC Bureau has been consulted on this tracking method (during the November 10 PAAD review for the 1989 program) and agreed that, because of the lack of foreign exchange controls, reimbursement (a procedure in accord with current Agency guidance) would be the most practical method. The CB has accumulated more than \$9 million of import documentation, which has been reviewed and approved by the Mission as being eligible. We are in the process of issuing a PIL to authorize reimbursement.

OIG COMMENTS

We do not believe that using ESF dollars to reimburse eligible transactions selected from the many financed by the Central Bank since August 31, 1987 meets the intent of either the 1987 continuing resolution or current Agency guidance. The intent of this guidance, in our opinion, was to permit A.I.D. to determine the end use of ESF dollars.

MANAGEMENT COMMENTS

The problem pertaining to the deposit of the local currency has arisen because the GOB never included in its 1987 calendar year budget the counterpart resources that were eventually jointly programmed for AID and multilateral donor projects signed with the Government. As a result, when requests for deposit of those resources into the Special Account were made, the National Treasury was unable to provide the funds. The only mechanism available to meet the local currency requirement was to request the CB to make the Bolivianos available through fiscal credits or simply, create money. This mechanism is highly inflationary and questionable as to its legality. As a result, the CB was reluctant to make those funds available according to the calendar of deposits established in POL No. 4, if those monies were not going to be immediately used. As of the end of November, the GOB has agreed to make \$2 million of local currency available through another fiscal credit and will make the remaining \$2,160,000 available from the 1989 budget. For the 1988 program, the GOB, through the National Treasury, has already agreed to make the full \$7,320,000 in local currency available according to a schedule of deposits provided to the Mission.

OIG COMMENTS

The Mission's response does not indicate what, if anything, the Mission plans to do to bring local currency deposit arrearages under the 1986 program up to date. We are pleased that the Government of Bolivia has agreed to a new deposit schedule for the 1987 local currency. This does not completely satisfy our concerns, however, since the Government did not comply with previous deposit schedules established on September 15, 1987 and February 24, 1988.

31

MANAGEMENT COMMENTS

The following are responses to recommendations a. to e. [now b. to f.]:

- a. [now b.] As noted above AID/W has approved the reimbursement method and the Mission is processing a PIL approving more than \$9.0 million in eligible import documentation, being maintained in the Mission and the CB. With regard to the local currency the GOB has yet to deposit \$1 million for 1986 program and \$4.1 million for 1987 program. The 1986 resources are being made available, on an as needed basis, to the Fondo Social de Emergencia, a highly effective public works program that mitigates the effects of unemployment. This is done to limit any inflationary impact and to date, there has been no interruption in fund flow. As stated above, for the 1987 program, the GOB will make \$2 million available in December and the remainder in early 1989. We believe that this recommendation should be eliminated from the draft report.

OIG COMMENTS

Recommendation 1.b is unresolved. We do not believe that additional ESF disbursements should be made until the Government of Bolivia uses the resources available under prior years' programs and makes the deposits it was required to make under these prior programs.

MANAGEMENT COMMENTS

- b. [now c.] By letter dated November 2, (copy attached), the GOB has agreed to make the \$7,320,000 equivalent in local currency available according to a schedule acceptable to the Mission. The new management unit in the Ministry of Planning is working on procedures to be implemented with all institutions receiving funding under the program to ensure proper use of funds.

OIG COMMENTS

Recommendation 1.c is resolved and will be closed once acceptable local currency disbursement procedures for the 1988 ESF program have been established.

MANAGEMENT COMMENTS

- c. [now d.] Responsibility for monitoring local currency deposits will be shared by the Project Development Office (official project office) and the Controller's Office.

OIG COMMENTS

Recommendation 1.d is unresolved. The Mission's response paraphrases local order 19-7, dated April 28, 1988, which provided that:

For the ESF program, [the Office of the] Controller is assigned as the Mission's project office for monitoring all resources.... [The Project Development and Implementation Office] will have day to day responsibility for the management and monitoring of the ESF local currency activities, including liaison with the Ministry of Planning and Coordination and the Central Bank....

This assignment of responsibility was evidently too vague to provide for effective verification of local currency deposits. For example, USAID/Bolivia informed us in writing on August 25, 1988 that all of the local currency deposits required under the 1987 program had been made when in fact the equivalent of \$4.2 million remained to be deposited. We continue to believe that a specific office within the Mission should be given responsibility for verifying that required local currency deposits are actually made.

MANAGEMENT COMMENTS

d. & e. [now e. and f.] These are now moot points. The Table VI and other data mentioned were prepared based on the best information available at the time. Revising tables of obsolete documents would be meaningless. As you state that the Mission indicated that this information was reported inadvertently and that "we found no evidence that would suggest otherwise," we suggest that these recommendations be deleted.

OIG COMMENTS

Recommendation 1.e and 1.f are unresolved. Three documents sent to A.I.D./Washington contained inaccurate information which made it appear that the 1986 and 1987 ESF programs had been implemented more rapidly than was the case. These reports must be corrected so that A.I.D./Washington can make informed decisions concerning these and future ESF programs.

MANAGEMENT COMMENTS

Recommendation No. 3 [Now Recommendation No. 2]

"We recommend that USAID/Bolivia modify the 1987 dollar accounting procedures to comply with A.I.D.'s amplified policy guidance on Economic Support Fund cash transfer assistance, or obtain AID/Washington approval of the current procedures."

-37

Response

The Mission believes that the discussion section for this recommendation accurately reflects what has happened with these two programs over the last two years. As stated above, we recognized many of the management deficiencies last year and have taken several steps to correct them.

However, before directly responding to this recommendation, we would again like to correct a misunderstanding in the report regarding dollar tracking and accountability as it pertains to the GOB foreign exchange system (as described on page 17 [now page 11] of your report). The GOB system, in no way, pretends to account for foreign exchange transactions. Bolivia maintains and will continue to maintain a free and open foreign exchange system. As discussed above, the CB manages foreign exchange through what is called "the Bolsin" and any person, public or private institution can buy foreign exchange through this mechanism. As long as the buyer of foreign exchange deposits his local currency, the CB does not track how that dollar is used. This was explained on several occasions to your auditors, and we hope that this issue is made clear.

With regard to recommendation No. 3, the dollar reimbursement procedure was discussed, during the November 10, 1988, PAAD review meeting. The problems involved in establishing a tracking system for countries like Bolivia that implement no controls over foreign exchange was thoroughly discussed and the Bureau agreed that the system currently being used under the 1987 program is the most appropriate. This discussion is included in the PAAD which the Bureau's cable will approve. We suggest this recommendation be deleted from the final report.

OIG COMMENTS

Recommendation No. 2 is unresolved because we do not believe that procedures which permit the host government to finance imports and then seek A.I.D. reimbursement for selected transactions meet the intent of the statutory and policy guidance on tracking ESF dollars. The intent of this guidance, in our view, was to permit A.I.D. to determine the end use of ESF dollars.

MANAGEMENT COMMENTS

Recommendation No. 4 [Now Recommendation No. 3]

"We recommend that USAID/Bolivia negotiate with the Government of Bolivia a program for earning interest on Economic Support Fund local currency, or prepare a determination demonstrating why interest should not be earned."

34

Response

With regard to this recommendation, the reason that interest is not earned on the Special Account is that internal CB procedures do not permit interest payments to balances in these types of accounts.

OIG COMMENTS

As discussed in the report, ESF local currency would have to be invested in Central Bank certificates of deposit in order to earn interest.

MANAGEMENT COMMENTS

Similarly, as we explained repeatedly to the auditors, we also continue to believe that, even if internal CB regulations permitted earning interest, the inflationary effects should not be so lightly dismissed.

OIG COMMENTS

We take issue with the phrase "as we explained repeatedly to the auditors." The question of whether or not to earn interest on ESF local currency was discussed with six different Mission officials on nine occasions from March 17, 1988 through August 24, 1988. Five of the six officials either had no opinion or consistently supported earning interest. Only one official ever opposed earning interest, and he changed his opinion twice during the course of our discussions.

MANAGEMENT COMMENTS

The auditors only addressed the interest issue of the 1986 and 1987 programs. Were such a policy implemented, it would also apply to the \$7,320,000 in 1988, the \$23,500,000 in 1989 and the proposed future year programs. Thus, the inflationary impact of an approximately \$45 million program (FY 86-88) could be substantially larger, depending on the amount of local currency on deposit at any one time.

The Mission is in the process of preparing the appropriate determination.

OIG COMMENTS

The Mission could elect to earn interest on the local currency for some years' programs and not for others. Alternatively, the Mission could choose to earn interest as long as the resulting inflationary impact remained acceptable, and discontinue this policy if and when the inflationary impact became significant. Recommendation No. 3 is resolved because USAID/Bolivia has the authority not to follow A.I.D.'s preference for earning interest. The recommendation will be closed when the Mission prepares a determination based on a realistic projection of how much interest would likely be earned and what effect this would have on Bolivia's money supply.

MANAGEMENT COMMENTS

Recommendation No. 5 [Now Recommendation No. 4]

"We recommend that USAID/Bolivia negotiate and sign a trust fund agreement amendment authorizing the Mission to manage narcotics awareness funds on behalf of the Government of Bolivia or return these funds to the Government."

Response

USAID/B management has decided to return the Narcotics Awareness trust fund money to the GOB. As was discussed with your auditors, the Mission does not favor establishing a program trust fund. However, we believe that there existed, and continue to exist, major management faults in the possible GOB organizations which would manage these funds. After carefully evaluating the alternatives, we have decided to turn the funds over to the PL 480 Secretariat. We will closely monitor the use of these funds, and believe that minimum standards of accountability can be maintained through such monitoring. We recognize this as an imperfect solution, but the best one available under the circumstances. A POL has been written authorizing this action and the money has already been transferred. We believe this action satisfies this recommendation.

With regard to your statement on page 24 [now page 16], first full paragraph, that the Mission managed the program trust fund because the GOB did not want to be associated with this activity, it is inaccurate and not reflective of either the GOB nor the Mission position. The Mission began managing these resources because of the sensitive nature of the use of these funds.

OIG COMMENTS

The significance of this clarification is not apparent to us, and the language used in our draft report was supported by a statement made to us by USAID/Bolivia's Director on March 11, 1988. However, we have changed the first full paragraph on page 16 to incorporate the language preferred by the Mission.

MANAGEMENT COMMENTS

When the local currency guidance was released, the Mission took the necessary action to comply. This should be reflected in the final report.

OIG COMMENTS

The final report states that USAID/Bolivia returned the narcotics awareness trust funds to the Government of Bolivia. We must point out, however, that the funds were returned after our audit ended in August

15

1988 and that guidance in effect since July 1985 required Missions to sign a trust fund agreement when managing funds on behalf of a host government.

MANAGEMENT COMMENTS

B. Compliance and Internal Control

The Mission has no further comments in this section as your observations have been addressed in other parts of this response.

C. Other Pertinent Matters

The Mission has very serious problems in this last section of Part II and strongly recommends that this section be dropped from the final report. First, as stated above, we feel that all reference to accounting and internal control deficiencies of the PL 480 Executive Secretariat be addressed in the PL 480 audit report.

OIG COMMENTS

A detailed discussion of internal control deficiencies in the Executive Secretariat and the UCCP will be included in our forthcoming report on USAID/Bolivia's PL 480 programs. However, since the Executive Secretariat and UCCP also managed ESF local currency, it is appropriate to summarize the internal control deficiencies in this report.

MANAGEMENT COMMENTS

Second, we take strong exception to the sentence that states "This meant that the UCCP could not properly account for \$95.2 million in PL 480 and ESF local currency." We believe that statements like this are unnecessary and border on the sensational. Neither the auditors nor this Mission have enough evidence to prove this statement.

OIG COMMENTS

We have included additional evidence for this statement in the report.

MANAGEMENT COMMENTS

We recognized more than a year ago the deficiencies of the internal controls of the ES and UCCP and began taking corrective action long before the audit began. Corrective action is in process right now to strengthen the ES and make a more dependable organization in its financial reporting and accounting and its technical monitoring.

31

OIG COMMENTS

We fully support USAID/Bolivia's efforts to strengthen the Executive Secretariat and the UCCP.

15

Report Recommendations

Page

Recommendation No. 1

5

We recommend that USAID/Bolivia:

- a. obtain from the Assistant Administrator for Latin America and the Caribbean a reevaluation of the need for the Bolivia Economic Support Fund Program and of the Government of Bolivia's management capacity to implement and manage an Economic Support Fund program;
- b. notify the Government of Bolivia that it will not approve any additional Economic Support Fund disbursements until the Government of Bolivia has used all of the Economic Support Fund dollars for agreed upon purposes, and has deposited the local currencies accruing from the 1986 and 1987 Economic Support Fund programs;
- c. obtain evidence that procedures for local currency disbursements under the 1988 program have been established which provide for disbursement of funds in accordance with the progress of each activity and liquidation of previous disbursements before additional disbursements are made;
- d. fix responsibility within the Mission for verifying that Economic Support Fund local currency deposits are made as agreed;
- e. submit to the Latin American and Caribbean Bureau a corrected 1990 annual budget submission table VI and a corrected program assistance approval document for the 1988 Economic Support Fund program; and
- f. consult with the Office of Legislative Affairs and the Latin American and Caribbean Bureau's Office of Development Programs, as appropriate, to determine whether or not the 1989 congressional presentation should also be corrected.

Recommendation No. 2

10

We recommend that USAID/Bolivia modify the 1987 dollar accounting procedures to comply with A.I.D.'s amplified policy guidance on Economic Support Fund cash transfer assistance.

39

	<u>Page</u>
<u>Recommendation No. 3</u>	13
<p>We recommend that USAID/Bolivia negotiate with the Government of Bolivia a program for earning interest on Economic Support Fund local currency or prepare a determination demonstrating why interest should not be earned.</p>	
<u>Recommendation No. 4</u>	16
<p>We recommend that USAID/Bolivia negotiate and sign a trust fund agreement amendment authorizing the Mission to manage narcotics awareness funds on behalf of the Government of Bolivia or return these funds to the Government.</p>	

APPENDIX 3

REPORT DISTRIBUTION

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