AUDIT OF USAID/EL SALVADOR LOCAL CURRENCY PROGRAM PART II - GENERATIONS

Audit Report No. 1-519-89-22
June 16, 1989

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June 16, 1989

MEMORANDUM

TO: D/USAID/El Salvador, Henry Bassford

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

SUBJECT: Audit of USAID/El Salvador Local Currency Program Part II - Generations

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of USAID/El Salvador Local Currency Program, Part II - Generations. 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 appended to this report. Because of its size and large number of recommendations, the draft report was divided into three parts. This report, Part II, contains three recommendations. All three recommendations are resolved and will be closed upon completion of planned or promised actions. Please advise me within 30 days of any additional actions taken to implement the recommendations.

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

EXECUTIVE SUMMARY

The United States provides part of its economic assistance to the Government of El Salvador through food aid programs authorized by the Agricultural Trade and Development Act of 1954 and Section 416 of the Agricultural Act of 1949. Under these programs the United States either sells at concessional terms or donates agricultural commodities to the Government of El Salvador. Common to these programs is the requirement that the Government of El Salvador provide an equivalent amount of local currency for the value of the commodities provided by the United States. The Government of El Salvador meets the local currency program requirement by selling the commodities in local commercial markets. For the three years ending December 31, 1987, the Government of El Salvador deposited into separate Central Bank of El Salvador accounts sale proceeds totaling $112.7 million in local currency which it jointly programmed annually with the United States.

The Regional Inspector General for Audit, Tegucigalpa, performed a program and compliance audit of USAID/El Salvador's local currency program. Specific audit objectives were to assess (i) the adequacy of USAID/El Salvador and GOES overall financial management of the local currency program, (ii) GOES compliance with local currency generation requirements, and (iii) the adequacy of USAID/El Salvador and GOES management systems over extraordinary budget activities. This report addresses the second objective. The other objectives are addressed in separate reports.

The audit found that USAID/El Salvador and Government of El Salvador (GOES) management of the local currency program had improved since the last Inspector General audit in 1985 but the GOES had not fully complied with local currency generation requirements.

Nevertheless, the audit found that both the Government of El Salvador and USAID/El Salvador had made progress, especially during the past two years, to strengthen the framework of the local currency program by implementing improved procedures to better ensure the effective and proper use of these scarce resources.

The audit found that the GOES commercial agents responsible for importing and selling program commodities had not always appropriately deposited local currency proceeds in the Central Bank of El Salvador.

Less local currency had been generated than required by the 1985 Title I agreement. This agreement requires that the proceeds accruing from the sale of commodities financed under the agreement not be less than the local currency equivalent of the dollars disbursed for such commodities. Less funds were generated because neither USAID/El Salvador nor the Government of El Salvador had established adequate control procedures to ensure that the minimum required local currency had been generated and deposited in the appropriate Central Bank account. As a result, $118,336 local currency equivalent was not available for economic developmental purposes and in other program years there may also be less generations than required by their respective agreements. The report recommends that USAID/El Salvador obtain evidence that the Government of El Salvador has established procedures to ensure that appropriate local currency deposits are made and that shortfalls have been recovered. USAID/El Salvador agreed with the finding and recommendation.

An estimated $13.0 to $16.7 million equivalent local currency should have been generated from the sale of powder milk donated under the 1983 Public Law 480 Title II Agreement. However, only $9.4 million in local currency had been deposited in the respective account. This significant shortfall of at least $3.6 million has remained unresolved for over two years. Neither USAID/El Salvador nor the Technical Secretariat for External Financing have effectively pressed the Government of El Salvador for restitution or otherwise for an appropriate resolution to this situation. As a result, less local currency than planned was available for developmental purposes. The report recommends that USAID/El Salvador determine the amount of shortfall and take appropriate measures to recover it. USAID/El Salvador agreed with the finding and was in the process of implementing the recommendation.

Local currency program agreements require that proceeds from the sale of Title I and Section 416 agricultural commodities be deposited promptly in the Central Bank. The audit disclosed that certain cash sales had not been deposited in a timely manner and that commercial agents could misrepresent the type of sales transaction for their financial benefit. These situations existed because the Technical Secretariat for External Financing and USAID/El Salvador had not adequately established commodity sale terms and conditions, sales reporting requirements, and other monitoring procedures over the sales agents or the Central Bank. As a result, implementation of local currency-financed activities had been delayed and one commercial agent had not deposited $25,312 in overdue sales proceeds. The report recommends that USAID/El Salvador obtain evidence that new control procedures have been implemented and that local currency shortfalls have been recovered. USAID/El Salvador agreed with the finding but not completely with the recommendation.

Office of the Inspector General

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PART I - INTRODUCTION

A. Background

The United States provides part of its economic assistance to the Government of El Salvador (GOES) through food aid programs authorized by the Agricultural Trade and Development Act of 1954 (Public Law 480) and Section 416 of the Agricultural Act of 1949 (Section 416). Under these programs the United States either sells at concessional terms or donates agricultural commodities to the GOES.

Common to these programs is the requirement that the GOES provide an equivalent amount of local currency for the value of the commodities provided by the United States. The GOES meets the local currency program requirement by selling the U.S. provided agricultural commodities in local commercial markets. Until 1987, the GOES used two commercial agents, the Mortgage Bank and the Agricultural Promotion Bank, to commercialize the commodities. In 1987, the Commercial Agricultural Bank was also designated as a commercial agent for a portion of the 1987 Public Law 480 agricultural commodities. The GOES establishes administrative procedures and regulations for its commercial agents through individual agreements.

The GOES deposits local currency sales proceeds in separate Central Bank accounts and jointly programs them annually with the United States through memoranda of understanding (MOU). For the three years ending December 31, 1987, the GOES had deposited local currency commodity sales proceeds totaling $112.7 million. Although provided in response to United States agreement provisions and jointly programmed, A.I.D. considers the GOES mainly responsible for these local currencies. USAID/El Salvador's Office of Development Planning and Programming is responsible for the Mission's overall management of the local currency program.

This is one of three Regional Inspector General for Audit, Tegucigalpa (RIG/A/T) reports covering USAID/El Salvador's local currency program. This report addresses issues related to the generation of local currencies under Public Law 480 and section 416 programs. The other two reports address overall program management issues and issues related to programming, disbursing, and monitoring of local currencies from the extraordinary budget.

As a result of this audit, the RIG/A/T issued a total of ten audit reports during fiscal year 1989 covering activities financed by or otherwise related to USAID/El Salvador's local currency program. See appendix 1 for a list of the other nine reports.

B. Audit Objectives and Scope

The Regional Inspector General for Audit, Tegucigalpa, performed a program and compliance audit of USAID/El Salvador's local currency program. The detailed audit work was conducted from May 2, 1988 to December 14, 1988 and covered the three years from January 1, 1985 through December 31, 1987. During this 3-year period, GOES and USAID/El Salvador jointly programmed the local currency equivalent of $661.7 million of which $563.5 million in local currency had been disbursed to implementing agencies. Of these disbursements, $112.7 million in local currency had been generated as a result of the Public Law 480 and Section 416 programs. Specific audit objectives were to assess (i) the adequacy of USAID/El Salvador and GOES overall financial management of the local currency program, (ii) GOES compliance with local currency generation requirements, and (iii) the adequacy of USAID/El Salvador and GOES management systems over extraordinary budget activities.

This report addresses the second specific audit objective. To accomplish this objective, we reviewed program regulations, management records, and other pertinent documents and interviewed officials at USAID/El Salvador, the United States Embassy, the United States Department of Agriculture, the Central Bank, the Court of Accounts, the Technical Secretariat for External Financing, three GOES designated commodity sales agents, and other GOES institutions.

We audited the USAID/El Salvador local currency program in previous years. The last such audit effort was in 1985. Significant previous findings were that GOES designated commodity sales agents had not always promptly deposited Public Law 480 Title I and II commodity sales proceeds in the Central Bank and that one implementing agency had used some project funds for ineligible purposes (see appendix 2 for a listing of previous years' reports).

USAID/El Salvador financed and contracted Price Waterhouse to assist with this audit. Price Waterhouse auditors worked under the direct supervision of the RIG/A/T auditors. We limited review of internal controls and compliance to the findings in this report and performed the audit in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The audit found that USAID/El Salvador and Government of El Salvador (GOES) management of the local currency program had improved since the last Inspector General audit in 1985 but the GOES had not fully complied with local currency generation requirements.

Nevertheless, the audit found that both the GOES and USAID/El Salvador had made progress, especially during the past two years, to strengthen the framework of the local currency program by implementing improved procedures to better ensure the effective and proper use of these scarce resources.

The audit found that the GOES commercial agents responsible for importing and selling program commodities had not always appropriately deposited local currency proceeds in the Central Bank of El Salvador. The report recommends ways to strengthen and clarify program guidance to better ensure that local currency generations are fully deposited in the Central Bank and in a timely manner and that specific shortfalls be recovered.

A. Findings and Recommendations

1. Required Public Law 480 Title I Local Currency Generations Have Not Always Been Achieved

Less local currency had been generated than required by the 1985 Title I agreement. This agreement requires that the proceeds accruing from the sale of commodities financed under the agreement not be less than the local currency equivalent of the dollars disbursed for such commodities. Less funds were generated because neither USAID/El Salvador nor the Government of El Salvador had established adequate control procedures to ensure that the minimum required local currency had been generated and deposited in the appropriate Central Bank account. As a result, $118,336 local currency equivalent was not available for economic developmental purposes and in other program years there may also be less generations than required by their respective agreements.

Recommendation No. 1

We recommend that USAID/El Salvador:

a. obtain evidence from the Technical Secretariat for External Financing that it has established adequate procedures to ensure that local currency deposits are at least equal to the amount required by their respective agreements; and

b. provide evidence that the Government of El Salvador has deposited the local currency equivalent of $118,336 into the 1985 Title I Central Bank account and has programmed this amount for appropriate developmental activities or provide evidence that the 1985 Title I Agreement has been amended to waive the recovery of this shortfall.

Discussion

As of December 31, 1987, the Technical Secretariat for External Financing (the Secretariat) reported that $48.35 million equivalent in commodity sale proceeds had been deposited in the 1985 Public Law 480 Title I program (Title I) account maintained in the Central Bank. The Secretariat reported that the last sale proceeds deposited to this account was in August 1986. The United States paid $48.47 million for the agriculture commodities provided under the 1985 Title I agreement. The program agreement required that the Government of El Salvador (GOES) deposit the equivalent amount in a separate account. However, the GOES deposited $118,336 less than required. The audit revealed that more local currency was generated and deposited than required by the 1986 Title I agreement and therefore program compliance for the 1986 agreement was not a problem. It was too early to comment on the 1987 Title I program, as sale proceeds' data had not been fully reported.

The 1985 Title I agreement specified that:

> The total amount of the proceeds accruing...from the sale of commodities financed under this agreement,...shall be not less than the local currency

> equivalent of the dollar disbursement by the Government of the exporting country [United States] in connection with the financing of the commodities...

The United States disbursed $48.47 million for the agricultural commodities covered by the 1985 agreement. The agreement also requires that an appropriate GOES audit authority certify to the receipt and expenditure of the commodity sale proceeds and report this information at least annually to USAID/El Salvador.

The audit found that the 1985 Title I local currency shortfall existed because neither USAID/El Salvador nor the Secretariat had established adequate control procedures to ensure that the minimum local currency required by the agreement had been generated and deposited in the appropriate Central Bank account.

The Secretariat relied primarily on its commercial sales agents for information on commodity shipments and sales. These agents reported, among other things, on the type and quantity of commodities received and proceeds generated from their sale. However, the agents did not compare actual sale proceeds to what was required by the Title I agreement nor could they without specifically knowing the agreement terms or how much the commodities cost the Commodity Credit Corporation (CCC), the United States Department of Agriculture agency responsible for procuring the Title I agricultural commodities in the United States.

The audit also found no evidence that the GOES audit agency (the Court of Accounts) had reviewed the receipt and deposit of Title I local currency proceeds. Officials of the Court of Accounts stated the Court was responsible for verifying the accuracy of Title I sales proceeds and deposits but it did not exercise this authority because of insufficient human resources. In lieu of a government review, the Secretariat had contracted a local accounting firm to examine receipts and disbursements of Title I local currencies from the Central Bank accounts. However, these audits also have not verified that actual sales proceeds at least equaled the minimum required by their respective agreements. The firms appeared to match sale proceeds with the value of commodities received at the ports. The accounting firm responsible for reviewing the program years 1983, through 1986 indicated in its June 1987 report that it was unable to determine the appropriateness of the local currency proceeds because USAID/El Salvador had not confirmed the CCC cost of commodities delivered under the Title I programs.

As a result of not systematically comparing actual deposits of sales proceeds with the minimum required by each agreement, less local currency may be generated than planned for developmental activities. This was the case in 1985, as $118,336 equivalent local currency less than planned was generated. Although this shortfall represented less than one percent of the total generated under the 1985 Title I agreement, it still was a significant amount. Procedures needed to be established to ensure that such shortfalls do not occur in the future.

Management Comments

USAID/El Salvador agreed with the finding and recommendation and described the actions that it planned to take to correct the situation.

Office of Inspector General Comments

The recommendation is resolved based on planned actions to correct the situation. It can be closed when USAID/El Salvador provides evidence of corrective action taken.

2. A 1983 Title II Local Currency Shortfall Has Not Been Resolved

An estimated $13.0 to $16.7 million equivalent local currency should have been generated from the sale of powder milk donated under the 1983 Public Law 480 Title II Agreement. However, only $9.4 million in local currency had been deposited in the respective account. This significant shortfall of at least $3.6 million has remained unresolved for over two years. Neither USAID/El Salvador nor the Technical Secretariat for External Financing have effectively pressed the Government of El Salvador for restitution or otherwise for an appropriate resolution to this situation. As a result, less local currency than planned was available for developmental purposes.

Recommendation No. 2

We recommend that USAID/El Salvador in consultation with the Technical Secretariat for External Financing determine the exact amount of shortfall and take appropriate measures to recover and program it or provide evidence that the 1983 Title II agreement has been amended to waive the recovery of the determined shortfall.

Discussion

On June 3, 1983, the El Salvador and United States Governments signed a Public Law 480 Title II (Section 206) transfer authorization agreement covering approximately 12,500 metric tons of non-fat dry powder milk. The donated milk was to be sold in El Salvador with the net sales proceeds used for developmental purposes. The agreement programmed the local currency equivalent of $16.7 million for developmental activities. This amount and the stated activities were revised in the November 25, 1983 memorandum of understanding (MOU). The MOU programmed the local currency equivalent of $16.5 million. A January 1985 agreement amendment reduced the expected generations further to the local currency equivalent of $14.5 million. Subsequent actions appeared to have reduced the amount further to $13 million as a result of donations, reduced sale prices and spoilage problems. The audit did not determine if these subsequent actions had been approved by appropriate USAID and GOES officials.

Program operating details were included in the MOU and in a subsidiary agreement signed on November 14, 1983, between the GOES and the Salvadoran Institute for the Regulation of Provisions (the Institute), the GOES agency charged with importing and selling the milk in El Salvador. As with Public Law 480 Title I, and Section 416 commodity sales proceeds, the Technical Secretariat for External Financing (the Secretariat) was designated to manage the planned net sales proceeds.

As of December 31, 1987, the Institute had deposited the local currency equivalent of $9.4 million in the applicable Central Bank account or $7.3 million less than originally anticipated by the agreement and $3.6 million less than the apparent revised amount.

The audit showed that the last local currency generation deposit made under this program was in August 1986. Since then, it was unclear what actions had been taken by USAID/El Salvador or the Secretariat to recover or otherwise resolve this shortfall. The files at the Secretariat and USAID/El Salvador were unclear on whether estimated sale proceeds had been officially modified or what other actions had been taken. One USAID official stated that some related Title II documents had been lost in the October 1986 earthquake. The files did support, however, that the Mission and the Secretariat had discussed, among themselves and with the Institute, the problem of delayed generations. At least twice the Secretariat had also requested the Court of Accounts, the GOES auditing agency, to audit the Institute's management of the program. However, we could not determine what effect these discussions and requests had on recovering or resolving the $3.6 million equivalent Title II shortfall.

As of March 31, 1988, the Secretariat's monthly financial report still indicated that the original $16.7 million equivalent had been programmed for developmental activities and that $9.8 million equivalent had been disbursed. The applicable Central Bank account statement showed that from September 1986 to May 1988 the account had a balance of the local currency equivalent of $173,507.

As a result, less local currency than planned was available for developmental purposes. To correct this situation, USAID/El Salvador and GOES officials needed to identify the amount still outstanding under the 1983 Public Law Title II agreement and to take appropriate measures for recovery and/or modify the agreement accordingly.

Management Comments

USAID/El Salvador agreed with the recommendation and was in the process of implementing it. However, the Mission stated that the shortfall amount in question was $1.89 million and not $3.6 million.

Office of Inspector General Comments

The recommendation is considered resolved based on USAID/El Salvador planned actions. It can be closed when USAID/El Salvador provides evidence that the correct shortfall amount has been determined and has been appropriately resolved.

3. Local Currency Generation Deposits Have Not Always Been Timely

Local currency program agreements require that proceeds from the sale of Title I and Section 416 agricultural commodities be deposited promptly in the Central Bank. The audit disclosed that certain cash sales had not been deposited in a timely manner and that commercial agents could misrepresent the type of sales transaction for their financial benefit. These situations existed because the Technical Secretariat for External Financing and USAID/El Salvador had not adequately established commodity sale terms and conditions, sales reporting requirements, and other monitoring procedures over the sales agents or the Central Bank. As a result, implementation of local currency-financed activities had been delayed and one commercial agent had not deposited $25,312 in overdue sales proceeds.

Recommendation No. 3

We recommend that USAID/El Salvador obtain evidence that the Technical Secretariat for External Financing has:

a. established procedures requiring it to insert in all active and future Title I and Section 416 subsidiary agreements with commercial sales agents the specific cash and credit sale terms and conditions including penalties for noncompliance and a requirement that the details of each sale be promptly reported to the Technical Secretariat for External Financing, USAID/El Salvador, and the Central Bank;

b. reviewed with the Central Bank its procedures for receiving and depositing sales proceeds and ensured that the Central Bank corrects any weaknesses that would delay timely and correct deposits;

c. established monitoring procedures such as periodically contacting commodity purchasers to verify the accuracy of sales transactions reported by the commercial agents;

d. reviewed the causes for the Mortgage Bank's 9 month delay in depositing the $1.3 million in local currency to the Central Bank and, if warranted, assess and collect appropriate penalties; and

e. recovered and programmed the $25,312, plus appropriate interest, from the Agricultural Promotion Bank for pre-1985 sales proceeds that have not been deposited in the Central Bank.

Discussion

El Salvador generates local currency from the sale of agricultural commodities that it receives from the United States under Title I of the Public Law 480 (Title I) and Section 416 of the Agricultural Act of 1949 (Section 416). Local currency memoranda of understanding (MOUs) between USAID/El Salvador and the Government of El Salvador (GOES) require the

GOES' commercial agents to deposit the local currency generated from the sale of agricultural commodities provided under these programs in separate accounts in the Central Bank.

To ensure the timely availability and efficient administration of these local currency generations, the MOUs require the GOES to sign agreements with its commercial agents establishing the procedures and regulations governing the local currency from the time of generation to the time of deposit in the Central Bank accounts.

These 1987 documents provide, among other things, that commodities can be sold on cash and/or credit terms as follows:

Cash - sale proceeds are to be deposited immediately by the commercial banks in the appropriate Central Bank program account.

Credit - sale proceeds are to be deposited in the appropriate Central Bank program accounts as payments are received. Credit is limited to 180 days at 17 percent interest. Of the 17 percent, the commercial bank is permitted to keep 8 percent, the Secretariat is to receive 8 percent and the Central Bank 1 percent. The commercial banks are to inform the Central Bank of credit sales and the payment schedule for each. If the commercial bank does not remit payments in accordance with the payment schedule, the Central Bank is authorized to charge the commercial bank accounts accordingly.

The audit found that although improvements had been made since the last Inspector General audit in 1985 to better ensure that sale proceeds and related revenues are fully and promptly deposited in the appropriate program accounts, the GOES still had inadequate assurance that sale proceeds and related revenues were being promptly deposited. This observation was based on an examination of 1987 Section 416 cash sale transactions.

The Mortgage Bank, which was the GOES sales agent for Section 416 commodities, appeared to have held some cash sale proceeds for up to seven months before transferring the funds to the Central Bank without compensating the local currency program for such delays. For example, on February 26, 1988, the Mortgage Bank transferred $590,807 equivalent to the Central Bank. This transfer represented 12 Section 416 cash sales that had been made during the period July 20, 1987 to February 2, 1988. The Mortgage Bank officer responsible for these commodity sales stated that it was the bank's practice not to transfer sales proceeds to the Central Bank until bills and documentation from the port authority and customs had been received and satisfied. The officer said that this process took as long as three months in some cases. However, Mortgage Bank records showed that $419,101 of this $590,807 1987 cash sale transfer, or 71 percent, had been delayed by more than four months.

In addition to these delays, the audit showed that 2 cash transfers reportedly made in 1987, totaling $1.3 million equivalent, took nearly 9 months to be deposited in the Section 416 account. The Mortgage Bank stated it advised the Central Bank to charge the Mortgage Bank account

$1,107,497 on August 12, 1987, and $166,731 on September 8, 1987. However, the Central Bank never executed the Mortgage Bank's request. On May 25, 1988, the Mortgage Bank sent the Central Bank two checks totaling nearly $1.3 million equivalent to cover the two unexecuted transfers because the Central Bank had not charged their account as requested. A Central Bank official could not confirm that the Mortgage Bank had requested its account be charged in August and September 1987. When RIG/A/T auditors showed the Central Bank official the transfer document reportedly used by the Mortgage Bank to have its account charged, the official stated the document was an internal Mortgage Bank document and not an appropriate document for a Central Bank response. The official indicated this may have been the reason the request was not promptly executed. The Secretariat's Deputy Director stated he was unaware of this specific deposit delay. The audit did not determine who was technically at fault in this particular situation.

In a related matter, the current audit identified that the Agricultural Promotion Bank had not fully deposited sale proceeds from earlier years. In January 1985, the Secretariat contracted a private accounting firm to audit Title I generations during the period July 18, 1980 to October 31, 1984. In its July 1985 report, the firm stated that as of June 1985, the Agricultural Promotion Bank had not yet transferred the local currency equivalent of $626,354 for previous years sales. In July and August 1985, the bank transferred the equivalent of $601,042. As of October 1989, the bank still owed $25,312. This amount with appropriate interest needed to be recovered.

Besides untimely deposits of cash sale proceeds, commercial agents may not have always accurately reported the method used to finance commodities. For example, a Mortgage Bank official stated that the bank had, at least on one recent occasion, used its own resources to finance a $2.9 million sale of Title I commodities to capture the full 17 percent interest charged to the purchaser. This was done without requesting approval from or notifying the Secretariat.

This particular financing scheme might have actually benefited both the local currency program and the bank because funds were made available for developmental purposes faster than they normally would have been and the bank received a higher return than it otherwise would have. However, if not controlled, it could be possible for a bank to abuse such flexibility to the detriment of the local currency program. For example, a bank could delay depositing cash sale proceeds in the Central Bank by claiming the actual cash sale as a credit sale. It could then loan out the cash sales proceeds at 17 percent interest and only be held accountable for the capital and nine percent interest after six months. The net effect would be that a bank could earn the equivalent of eight percent interest on the cash sale proceeds for six months. No such cases were actually identified, however, the audit showed that such cases could potentially occur under the current commodity sales reporting system without detection.

Delays in depositing cash sales in the Central Bank have occurred because Mortgage Bank personnel had not fully reported the details of cash transactions to the Central Bank or to the Secretariat. Furthermore, the Central Bank may not have always promptly executed commercial banks' request to charge their account because of inappropriate deposit procedures.

Contributing to these problems and to the inaccurate reporting of methods used by the purchaser to finance commodity sales, was the limited monitoring of these activities by the Secretariat and other local currency managing entities. The two principal commercial banks visited stated that neither the Secretariat nor USAID/El Salvador representatives had visited the banks to review their commodity shipment and sales records. Secretariat officials also acknowledged that they did not know if the banks had promptly deposited sales proceeds. The Secretariat relied on the commercial banks to do all the accounting for commodity sale proceeds. Also, the GOES Court of Accounts, the government's highest auditing agency, did not review commodity sales transactions or deposits. An official at the Central Bank stated that the Bank was not advised as to when cash sales were actually made nor did it attempt to verify whether the sale was actually on a cash or credit basis.

Delayed cash deposits could hinder the timely implementation of developmental projects. In a January 1988 USAID/El Salvador cable reporting the status of Title I self-help measures to AID/Washington, it was noted that implementation of the "support to livestock research and prevention of exotic diseases" activity had been delayed because disbursements began later than anticipated. The cable indicated that $180,000 local currency equivalent was to be provided from Section 416 sale proceeds to finance this activity during the period April through December 1987. The Secretariat reported that the first Section 416 sales proceeds deposited in the Central Bank was October 19, 1987.

However, as previously discussed, over $1.0 million equivalent in Section 416 commodity local currency cash sales should have been deposited by August 1987, or at least two months earlier than the actual first deposit. Such delays could also result in undue benefits to the commercial banks. The Mortgage Bank benefited from this delay whether or not it was at fault. The Agricultural Promotion Bank had benefited from the use of $25,312 in pre-1985 sale proceeds that had not been deposited in the Central Bank.

The Secretariat needed to establish tighter procedures and controls over commodity sale transactions and deposits to better ensure that sales proceeds were promptly deposited in the Central Bank and that commercial agents do not benefit inappropriately under the program.

Mission Comments

USAID/El Salvador agreed with the finding but not completely with the recommendation. Specifically, the Mission thought part "d" of the recommendation was too vague and that it could cause an unnecessary dispute between the Mortgage Bank and the Central Bank. It requested that this part of the recommendation be deleted.

Office of Inspector General Comments

RIG/A/T believes it is important to understand why the Mortgage Bank did not respond sooner in this situation, especially given the large amounts involved.

The Mortgage Bank has a responsibility to ensure that program funds are promptly deposited in the Central Bank. Why it took the Mortgage Bank nine months to realize that the Central Bank had not charged its account $1.3 million needs to be determined and the causes corrected to prevent repeat occurrances. Therefore, part "d" of the recommendation remains.

The recommendation is resolved based on the Mission's general acceptance to implement the recommended actions. It can be closed when USAID/El Salvador provides evidence of corrective actions taken.

B. Compliance and Internal Control

1. Compliance

Our review of compliance was limited to the findings presented in this report. The audit identified the following two compliance deficiencies.

First, the GOES had not deposited the full amount of local currency required by the 1985 Public Law 480 Title I and the 1983 Title II agreements (see finding Nos. 1 and 2).

Second, the Mortgage Bank had not deposited Section 416 sales proceeds and the Agricultural Promotion Bank had not deposited pre-1985 Public Law 480 Title I sale proceeds in the Central Bank in the time required by program agreements (see finding No. 3).

2. Internal Control

Our review of internal controls was limited to the findings presented in this report. The audit identified the following internal control weakness. Neither the Secretariat nor USAID/El Salvador had established adequate control procedures to ensure that local currency generations were fully deposited in the Central Bank and within the prescribed timeframe (see finding Nos. 1 and 3).

C. Other Pertinent Matters

The following other pertinent matter was identified during the audit.

The rationale or justification for using basically the same two sales agents for importing and marketing agricultural products under the Public Law 480 and Section 416 programs was unclear. Officials at the Agricultural Promotion Bank and the Mortgage Bank stated that their banks had been used as sales agents since 1980 and 1984 respectively. The following reasons were offered by GOES and bank officials as to why these institutions were used:

-- these were the only banks authorized to import commodities without paying import taxes,

-- these bank operations were related to agricultural markets, and

-- these banks had a proven track record in importing agricultural commodities.

Discussions with officials at another commercial bank and at the Central Bank generally contradicted these claims. An official at the Commercial Agricultural Bank stated that his bank had experienced no problems with customs or taxes when importing commodities at the GOES behalf. He and an official at the Central Bank indicated that other commercial banks service the agricultural and food processing markets and that these banks were as large and had the same import and marketing capabilities as the two subject banks. The United States Department of Agriculture representative in El Salvador stated that a former President of El Salvador was a past executive of the Mortgage Bank and that was why it was designated as a sales agent.

The banks' interest in these programs is understood as they have little financial risks. First, they are not required to use their own funds to purchase the commodities. Second, according to one of the sales agents, its Title I commodity customers are qualified in advance by the Ministry of Agriculture and Economy. In other words, their customers are considered good credit risks and therefore the banks can advance them funds with limited risk of default.

The compensation arrangements with these institutions did not appear to be adequately supported. Initially, the agreements signed by the banks allowed them to keep all the interest earned on credit sales to food processors. The prior Inspector General report pointed out that the interest earned on credit sales belonged to the local currency program and that the banks should only be allowed to withhold the necessary amount to cover their administrative expenses. Subsequent agreements provided that the banks were required to deposit credit sale proceeds in the Central Bank within 180 days of unloading the commodities in El Salvador and were limited to keeping only 8 percent of the credit sale interest rate of 17 percent for their expenses. The 1988 agreements have lowered this percentage to four percent. However, the audit found no documentation supporting either the eight or four percent. These percentages appeared to have been arbitrarily established by the GOES.

Regardless of the facts behind the use and compensation of the two banks, the appearance given is that they are receiving preferential treatment. In our opinion, the Mission should review with the GOES the current sales agent arrangements and explore with them the possibility of allowing other commercial banks to participate in the program through a competitive bidding process. This process could be used to establish the commodities that each bank would be assigned to import and market and their compensation. The Mission and GOES should also explore having the banks advance the sales proceeds, in return for allowing them to keep all interest earned on credit sales. This would expedite the availability of funds for programming and development purposes. Officials of two banks visited during the audit expressed interest in this possibility.

AGENCY FOR INTERNATIONAL DEVELOPMENT
UNITED STATES OF AMERICA A. I. D. MISSION
TO EL SALVADOR
C/O AMERICAN EMBASSY.
SAN SALVADOR, EL SALVADOR, C. A.

June 2, 1989

MEMORANDUM

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

FROM: Henry H. Bassford, Mission Director, USAID/El Salvador

SUBJECT: Mission's Response to the Draft Audit Report on the Local Currency Program [Part II - Generations]

Please find attached the Mission's response to the twelve [three] recommendations contained in the above mentioned draft audit report. We sincerely appreciate the extension granted to the Mission in responding to this draft report and feel inclusion of our comments should strengthen the report as a viable management tool.

We are sending this response today, both by FAX and via DHL.

RECEIVED
US AID
5 JUN. 1989
RIG OFFICE

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Related Local Currency Audit Reports

Audit Report No.	Title	Date Issued
1-519-89-08	Follow-up Review of Recommendations No. 6 and No. 1 b), Audit Report No. 1-519-85-13, USAID/El Salvador Private Sector Support Program and Public Law 480 Local Currency Generations, Dated September 26, 1985	01/30/89
1-519-89-10	Audit of USAID/El Salvador Balance of Payments Program	03/15/89
1-519-89-11	Audit of Selected Local Currency-Financed Activities of the National Commission for Assisting Displaced Population in El Salvador	03/16/89
1-519-89-12	Audit of Selected Local Currency-Financed Activities of the El Salvador Ministry of Public Health and Social Assistance	03/17/89
1-519-89-13	Audit of Selected Local Currency-Financed Activities of the National Plan for Basic Rural Sanitation in El Salvador	03/20/89
1-519-89-16	Audit of the Salvadoran Court of Accounts' Review and Implementation of Local Currency-Financed Activities	03/30/89
1-519-89-17	Audit of the Local Currency-Financed Central Bank Credit Line Program	03/31/89
1-519-89-21	Audit of USAID/El Salvador Local Currency Program, Part I - Overall Program Management	06/16/89
1-519-89-23	Audit of USAID/El Salvador Local Currency Program, Part III - Extraordinary Budget Activities	06/16/89

Previous Years' El Salvador Local Currency Reports

Report No.	Title	Date
1-519-82-5	Private Sector Support Program Grant No. 519-0267 (Loan No. 519-K-030) USAID/El Salvador	01/20/82
1-519-83-8	Private Sector Support Program Grant No. 519-0267 (Loan No. 519-K-030) USAID/El Salvador	04/20/83
1-519-85-13	Audit of Private Sector Support Program and P.L. 480 Local Currency USAID/El Salvador	09/26/85

Recommendation No. 1

"That USAID/El Salvador

a. obtain evidence from SETEFE that it has established adequate procedures to ensure that local currency deposits are at least equal to the amount required by their respective agreements; and

b. provide evidence that the Government of El Salvador has deposited the local currency equivalent of $118,336 into the 1985 Title I BCR account and has programmed this amount for appropriate developmental activities or provide evidence that the 1985 Title I Agreement has been amended to waive the recovery of this shortfall."

The Mission concurs with both parts of this recommendation. Concerning part a., the suggested system for follow-up on actual local currency deposits is that the Mission, principally DPP in coordination with SETEFE, will perform random spot checks and end-of-period reconciliations in the BCR and other commercial agents in the banking system to assess the state of the accounts. Guidance to cover this process will be provided in the new local currency MOM.

Concerning part b., USAID will collaborate with SETEFE to determine the actual amount of local currency, relative to the 1985 Title I Agreement, not deposited in the BCR account. Once this review is completed and the outstanding amount determined, we will request that the GOES (viz., Ministry of the Treasury) reimburse the stipulated amounts to the extraordinary budget from other than USG furnished resources. The Mission believes that this review will be completed by 9/30/89.

Recommendation No. 2

"That USAID/El Salvador, in consultation with SETEFE determine the exact amount of shortfall and take appropriate measures to recover and program it or provide evidence that the 1983 Title II agreement has been amended to waive the recovery of the determined shortfall."

While the Mission concurs with this recommendation, it is important to point out that the total value of milk sales not remitted under IRA's responsibility was $1.89 million not the $3.6 million reported in the draft audit report. The Mission is in the process of working with SETEFE to reconcile this account. Once the reconciliation process is completed (estimated to be in September 1989), the Mission will either request reimbursement or have the 1983 Agreement amended by the proper U.S. authority to waive the recovery of the determined shortfall.

Recommendation No. 3

"We recommend that USAID/El Salvador obtain evidence that the SETEFE has:

a. established procedures requiring it to insert in each active and future Title I and Section 416 subsidiary agreements with commercial sales agents the specific cash and credit sale terms and conditions including penalties for non-compliance and a requirement that the details of each sale be promptly reported to SETEFE, USAID/El Salvador, and the Central Bank (BCR);

b. reviewed with the BCR its procedures for receiving and depositing sales proceeds and ensured that the BCR corrects any weaknesses that would delay timely and correct deposits;

c. established monitoring procedures such as periodically contacting commodity purchasers to verify the accuracy of sales transactions reported by the commercial agents;

d. reviewed the causes for the Mortgage Bank's 9 month delay in depositing the $1.3 million in local currency to the BCR and, if warranted, assess and collect appropriate penalties; and

e. recovered and programmed the $25,312, plus appropriate interest, from the Agricultural Promotion Bank for pre-1985 sales proceeds that have not been deposited in the BCR."

The Mission concurs with parts a., b. and c. of the recommendation. Part d. should be deleted from the final report. Page 12 of the draft audit report states that "the auditors did not determine who was technically at fault in this situation" (viz., a delay in the deposit of $1.3 million by the Mortgage Bank relative to the 1987 Section 416 program). How can the Mission close such a vague recommendation? To bill the Mortgage Bank for delays, which only might have been their fault, would probably initiate a dispute between the Mortgage Bank and the BCR over a question which the RIG could not or did not have time to resolve. Time and effort expended in such a dispute will probably not result in a clear answer and will detract from the resources available to implement parts a.-c.

With respect to part e. of the recommendation, the Mission will work with SETEFE to determine the actual amount not deposited in the BCR. Once this amount is determined, we will request that the GOES (viz., Ministry of the Treasury) reimburse the required amount to the extraordinary budget with resources from non-USG resources.

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