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Regional Inspector General for Audit
Tegucigalpa, Honduras

Audit of The Panama Assistance Program Funded by Public Law 101-302 as of November 30, 1991

Audit Report No. 1-525-92-006
March 30, 1992

INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Regional Inspector General for Audit
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March 30, 1992

MEMORANDUM

TO: USAID/Panama Director, Thomas W. Stukel

B R Howard

FROM: RIG/A/T, Reginald Howard

SUBJECT: Audit of the Panama Assistance Program Funded by Public Law 101-302 as of November 30, 1991, Audit Report No. 1-525-92-006

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of the Panama Assistance Program Funded by Public Law 101-302 as of November 30, 1991. The final audit report is being transmitted to you for your action.

In preparing this report we reviewed your comments on the draft report. A summation of you comments has been included in the Executive Summary and after the appropriate audit objectives. The Mission's comments are presented in their entirety in Appendix II.

Based upon reported actions already taken, Recommendation Nos. 3, 4, and 5 are resolved while Nos. 1, 2, and 6 remain unresolved. Please respond to this report within 30 days indicating any actions taken to implement the recommendations.

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

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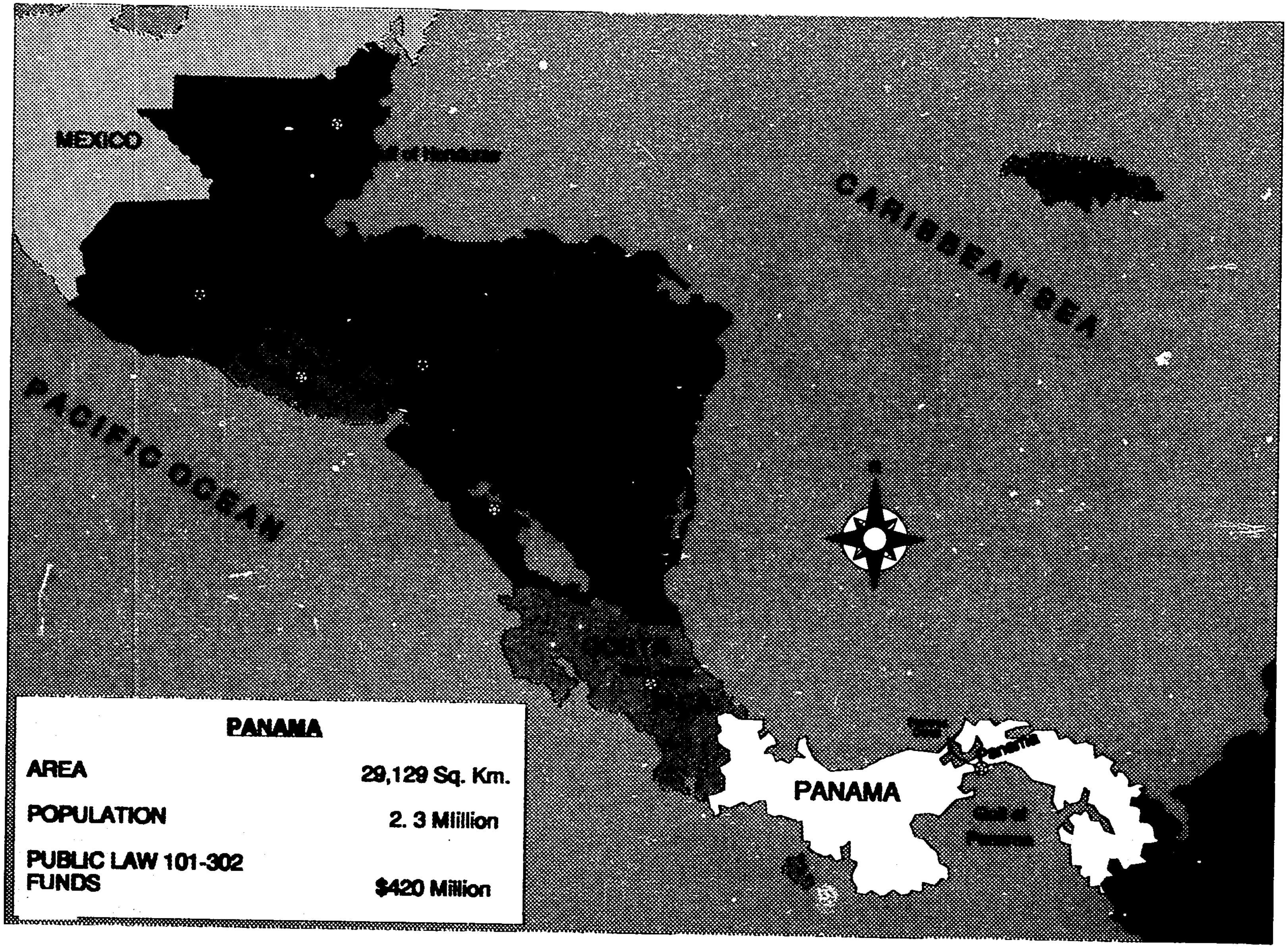
GLOSSARY

Act	The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act
A.I.D.	Agency for International Development
A.I.D. Evaluation Handbook	A.I.D. Handbook 3, Supplement to Chapter 12
A.I.D./Washington /FM	A.I.D.'s Financial Management Office
AIFLD	American Institute for Free Labor Development
BNP	National Bank of Panama
CAPEL	Center for Electoral Planning and Promotion
CBN	National Banking Commission
CENA	National Economic Council
CG	Controller General
CLASP	Caribbean and Latin American Scholarship Program
COSPAE	Council of the Private Sector for Educational Assistance
Cps	Conditions Precedent
ESF	Economic Support Fund
FAA	Foreign Assistance Act
GOP	Government of Panama
IBRD	The World Bank
ICD	Interbank Certificate of Deposit
IDB	InterAmerican Development Bank
IFIs	International Financial Institutions
IIDH	Inter-American Institute of Human Rights
IMF	International Monetary Fund
INRENARE	National Institute for Renewable Natural Resources
IRS	Internal Revenue Service
LAC Bureau	A.I.D./Washington/Latin America and Caribbean Bureau

MACS	Mission Accounting and Control System
MHT	Ministry of Finance and Treasury
MIPPE	Ministry of Planning and Economic Policy
MIVI	Ministry of Housing
NATURA	Nature Conservation Foundation
OMB	Office of Management and Budget
PAAD	Program Assistance Approval Document
PANAJURU	National Foundation for Panamanian Rural Youth
PBs	Participating Banks
The Mission	USAID/Panama
USIA	United States Information Agency


MEXICO
CARIBBEAN SEA
PACIFIC OCEAN
PANAMA
PANAMA
AREA 29,129 Sq. Km.
POPULATION 2. 3 Miillion
PUBLIC LAW 101-302 FUNDS $420 Million

EXECUTIVE SUMMARY

Background

The Congress passed the Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act (Act), and it was signed into law on May 25, 1990. The Act included $420 million in Economic Support Fund assistance to help Panama: restore a political democracy and market economy, normalize its relations with international financial institutions, develop the private sector, enter into agreements on mutual legal assistance and exchange of records in narcotics investigations, address a backlog of public sector investment needs, and develop improved capacities in a variety of areas including police services, justice, financial administration, and environmental protection.

By November 30, 1991, the Agency for International Development (A.I.D.) had developed two cash transfer programs and funded 19 development projects to implement the above Assistance Program. All of the funds had been obligated by that date and accrued expenditures were $159.8 million.[1]

The Act requires A.I.D.'s Inspector General to audit the Economic Support Fund programs provided under the Act in order to assess the financial management and administrative systems established by A.I.D. to control such programs. Semiannual audits were required through the end of fiscal year 1991. This report presents the results of our third and final semiannual audit in response to the Act and covers Assistance Program activities from May 25, 1990 through November 30, 1991.

Audit Objectives

We audited the Assistance Program in accordance with generally accepted government auditing standards. (See Scope and Methodology, Appendix I.) Our field work was conducted from September to December 1991 to answer the following questions:

- Did A.I.D. implement the cash transfer assistance under the Economic Recovery Program in accordance with program authorization documents and agreement terms?

[1] Total accrued expenditures through January 31, 1992 were $331.8 million.

- Did A.I.D. implement the cash transfer assistance under the Private Sector Reactivation Program in accordance with program authorization documents and agreement terms?

- Did A.I.D. establish and maintain financial and administrative systems to ensure that development project activities were implemented in accordance with A.I.D. policies and procedures?

Summary of Audit

The audit found that USAID/Panama had implemented the cash transfer assistance under the Economic Recovery Program in accordance with program authorization documents and agreement terms. The audit found, however, that the second phase of the Private Sector Reactivation Program had not been implemented in accordance with the authorization document and agreement terms because a provision which would have established a linkage between the program and new lending to reactivate Panama's private sector was not incorporated into the agreement. As a result it was not possible to assess whether the program's funds were used for the types of activities the program was meant to support. (See page 14.)

The audit found that the need for the Private Sector Reactivation Program has never been analytically established. Because circumstances have changed since this program began, the assistance may no longer be necessary thereby allowing the funds to be applied to other purposes specified in the agreement. (See page 24.)

Regarding development projects, as of our audit cut-off date there had been limited implementation progress for activities funded through the Act. However, based upon the progress to that date the audit found that USAID/Panama implemented the areas of technical assistance and commodities in accordance with A.I.D.'s policies and procedures. However because of the limited sample size reviewed and the early stage of implementation we are limiting our positive conclusions to the projects tested. (See page 29.)

The audit found that USAID/Panama's compliance with the A.I.D.'s policies and procedures regarding its participant training program was in need of increased supervisory attention. Health and accident coverage for participants was not timely, project accrued expenditure data was inaccurate and differences between the figures in expenditure reports and liquidation vouchers remained unverified. USAID/Panama agreed that its participant training program needed increased attention and took corrective action. (See page 30.)

Lastly, the audit noted three shortcomings regarding USAID/Panama's system for managing audit requirements: (1) not all assistance agreements included the current version standard provisions for financial audit (see page 35), (2) the Mission had not established formal systems to monitor audit requirements and track audit recommendations (see page 36), and (3) most assistance agreements lacked specific budgets for financial audits (see page 36).

Summary of Audit Findings

Funds Provided Under The Economic Recovery Program Had Not Been Disbursed As Quickly As Planned

The Economic Recovery Program had not been implemented as quickly as planned. Program design documents anticipated that the program's total funding of $243.85 million would be disbursed within nine months--by March 1991. However, as of November 30, 1991, seventeen months after the program began, only $29.85 million, or 12 percent of the program's funds, had been disbursed by A.I.D. This $214 million short-fall in disbursements--$130 million to clear the debt arrearages of the Government of Panama (GOP) with international financial institutions (IFIs) and $84 million to support the GOP public sector investment budget--happened because the GOP had not implemented policy reforms required by the agreement in support of the IFIs. These policy reforms and clearage of debt arrears to the IFIs were required by the IFIs before they would make further loans to the GOP. Therefore, the lack of these reforms was blocking further resource flows both from the IFIs and A.I.D. While at the time of our audit cut-off date it was uncertain whether the GOP would implement some of the policy reforms required, breakthroughs occurred since that date and A.I.D. has released all but $42 million. However final implementation of some policy reforms has yet to be completed. Since A.I.D.'s management of the program has effectively supported the IFIs in making progress on the desired policy reforms, we are making no recommendations.

The Private Sector Reactivation Program Was Not Being Implemented As Authorized

To address the need for reactivating the Panamanian private sector development, A.I.D. provided funds to Panama's private banking system. The program's authorization documents provided that participating banks were to submit plans for their incremental lending which, if approved and executed, A.I.D. funding of 50 percent would be provided through the purchase of interbank certificates of deposit (ICDs). We found that the authorization document provision requiring a lending plan was dropped as a prerequisite for loan approval in the agreement with the GOP, and accordingly such plans were not submitted. Subsequently an Operations Manual was developed which provided that loans taking place since the signing of the agreement (July 24,1990) would be eligible. These changes led to the entire $107.9 million under the program being disbursed based on past versus prospective lending activity. There was no way to assess whether the participating banks would have made the loans in the absence of the program, nor was there a way to determine whether the funds received under the program resulted in increased lending for the specific types of activities the program was intended to support. No alternative mechanism was developed to show that eligible new lending would take place as a result of the program as opposed to simply reimbursing banks for old lending. Considering that repayments of ICDs can be used to purchase additional ICDs, the Mission should require the submission of lending plans as provided in the authorization documents.

The Private Sector's Need For More Program Funds Should Be Determined

Under the Private Sector Reactivation Program's agreement terms, A.I.D. must provide approval by July 25, 1992, if reflow funds from the repayment of ICDs are to be used to purchase additional ICDs and if so, to what extent. Although the Mission evaluated the program in 1991, the results were inconclusive and the Panamanian private sector's need for the program's funds was not determined. Without this determination reflow funds should not be used to purchase additional ICDs since the Mission would have no assurances that reactivation of the private sector is still needed some two years after the passage of the Act which provided for such emergency measures. Even if a determination is made that the program is still needed, there should be assurance that purchases of ICDs will result in credit to eligible private sector activities that would not have otherwise occurred in the absence of the program.

With Exceptions Development Projects Had Been Implemented in Accordance with A.I.D. Policies and Procedures

Within the category of development projects, the audit reviewed the areas of technical assistance, commodities, participant training and audit provision. For the development projects tested, USAID/Panama followed A.I.D.'s policies and procedures regarding the provision of technical assistance and commodities. Regarding participant training and audit provision, with exceptions, USAID/Panama followed A.I.D.'s policies and procedures. The problem areas below summarize the exceptions.

USAID/Panama Needs To Better Manage Its Participant Training Program

A.I.D. missions are required to designate an officer to oversee the management and implementation of their participant training programs. This officer is to ensure that every participant training program is conducted in accordance with A.I.D. Handbook 10, "Participant Training". Additionally, A.I.D.'s Controllers Guidebook and A.I.D. Handbook 19, "Financial Management", require that A.I.D. use the accrual expenditure system of accounting. Financial records and reports should accurately reflect the status of project activities. USAID/Panama did not fully adhere to this practice or fully comply in all cases with handbook requirements in implementing its participant training program because proper monitorship was lacking. This lack of oversight resulted in inaccurate accounting accruals, unverified financial discrepancies, and inappropriate processing of trainees. USAID/Panama agreed that the program had problem areas and has acted to strengthen its monitoring of the program.

Current Version Standard Provisions for Audit Need To Be Used in All Agreements

Current Handbook 13 standard provisions for audit require that non-U.S. nongovernmental grantees have audits performed of their organizations which meet U.S. Government Auditing Standards. This Handbook provision was revised on May 17, 1991. USAID/Panama was not using the current version standard audit provision in five of the six agreements we reviewed.

Systems To Monitor Audit Requirements And Track Audit Recommendations Need To Be Established

Each U.S. Government agency is required to establish audit follow-up systems. The Mission had not established such systems because priorities had been placed on other Mission activities. The Mission should not further delay the establishment of audit follow-up systems because its overall program is now entering the stage where increasing numbers of audits will be performed. The audits and recommendations need to be tracked.

Specific Budgets for Audit Are Needed for Projects

According to A.I.D. policy, audit coverage must be evaluated in planning documentation and project funds should be budgeted accordingly for independent audits. A.I.D. also differentiates audits from evaluations. USAID/Panama had not provided budgets for audit in some of its agreements and when budgets were provided, they were frequently combined budgets for audits and evaluations. This occurred because Mission personnel were not aware of A.I.D.'s requirement concerning separate budget line items for audit.

Summary of Recommendations

This report contains six recommendations to correct the problem areas noted by the audit. The main recommendation concerns the Private Sector Reactivation Program.

It requires USAID/Panama to determine the need for more program funds by the private sector, amend the program grant agreement to require participating banks to plan and to submit for review and approval their intended incremental lending activities, and for the program's funds to be disbursed when the planned lending takes place.

Management Comments and Our Evaluation

USAID/Panama disagreed with our conclusions and recommendations concerning the Private Sector Reactivation Program. The Mission's principal area of disagreement was also a major point of disagreement in our prior audit report (Report No. 1-525-91-014) issued on September 12, 1991 where we first surfaced this finding.[2] Their disagreement centers on the level of control needed to ensure that Program funds are used to accomplish its intended purpose of increasing credit to the private sector. The Mission believes that this purpose can be accomplished by simply adding liquidity to the banking system through the purchase of ICDs and has used macroeconomic analysis to lend support to their argument that such increase in credit has occurred.

Macroeconomic analysis was discussed in the Program Assistance Approval Document. This discussion, however, centers around justifying the use of a program based upon credit expansion as a means of implementing the Act requirement that A.I.D. should address Panama's private sector development needs. The control technique, as established in the Program Assistance Approval Document, which would provide assurance that A.I.D. funds actually increased credit to the private sector development was not, however, based upon macroeconomic analysis. Rather the control technique was based upon linking A.I.D. funds to the purchase of ICDs supported by incremental new lending pre-approved by the implementing entity. This issue has been repeatedly discussed with USAID/Panama management who has consistently disagreed with this finding.

In reviewing management comments in their entirety, it seems to us that a root cause of this long standing disagreement is contained in the management comment as follows:

> In order to support the conclusion of the draft report that the Program must demonstrate a linkage to new/prospective lending to show that implementation is in accordance with authorization documents and

[2] An advance copy of this finding was provided to USAID/Panama by transmittal memorandum dated June 17, 1991, because of our concern over an impending disbursement of $35.9 million under this Program and the impact this issue could have on such disbursement. Although this issue has not been resolved USAID/Panama disbursed the $35.9 million on August 16, 1991.

> agreement terms, it would first be necessary to accept the Program purpose as redefined in the draft audit report as opposed to what was actually approved by the appropriate A.I.D./W officials. [The Mission,in their comments, did not provide clear information on what they considered to be our redefinition of the program.]

In an effort to settle this long standing issue in this, our third and final report on the Panama Assistance Program, the following discussion cites sections of the Act, the Program Assistance Approval Document, and the implementing agreement.

This Program was to satisfy the Act requirements regarding private sector development needs in Panama. A.I.D.'s Congressional Notification had as its purpose:

> To assist the Government of Panama (GOP) to reactivate the banking system and to increase credit to the private sector in Panama.

This notification explained that the program consisted of two phases, the first phase was to disburse as much of the $107.9 million as needed to support an expected "run" on the banks (reactivate the banking system). This expected run did not occur and accordingly no funds were used to reactivate the banking system. All of the funds were then used to support the second phase which, as stated in the Congressional Notification, was "...to rediscount new production, working capital and investment loans for the private sector."

Regarding the second phase, A.I.D.'s Program Assistance Approval Document stated that the purpose was to increase credit to the private sector in Panama. In implementing the second phase this document stated:

> Banks that plan to expand their medium and long term loan portfolio (loans of between one and five years) will submit to the BNP [National Bank of Panama] a description of the incremental lending that they plan to make within the next 30 days. This lending must be for investments in new plant and equipment, for construction, for mortgages for newly constructed buildings, or for incremental working capital. If the proposed loan portfolio meets the eligibility requirements of the Program, the BNP will agree to purchase interbank certificates of deposit (ICDs) from the PB [participating bank] equal to one half the value of the portfolio. A commitment fee of 0.5% will be charged to those PBs wanting assurances that funds will be available when they submit their packages. The period of commitment will not exceed 30 days. After the PB makes the additional loans, it will submit all documentation to the BNP and the BNP will purchase ICDs in an amount equivalent to one half of the value of the loan portfolio.

Normally, cash transfer programs have policy reform conditions. This program did not have such conditions as it was believed policy reform conditions in the other cash transfer program were sufficient. Accordingly, A.I.D. sought to meet the Congressional intent of increasing credit to the private sector by more direct means. A.I.D. was nevertheless concerned that this second phase not take on aspects of a project (rather than a program) that would require detailed monitoring to ensure A.I.D. funds did not finance prohibited or restricted items. In responding to this concern USAID/Panama explained that the ". . . implementing agency will review bank plans to expand productive lending and actual expansion of lending to ensure banks had demand for more lending." Then and only then were the ICDs to be purchased with A.I.D. funds. Under this concept A.I.D. would obtain assurance that an expansion of credit to the private sector development occurred but that the end use of A.I.D. funds would be purchase of an ICD not the financing of individual loans, thereby avoiding unwanted monitoring activities--a very carefully planned agenda.

However, for some unexplained reason, USAID/Panama signed an agreement with the GOP which completely bypassed this planned agenda. Rather than being used to purchase ICDs that were based on expanding productive lending as required by the authorization document, A.I.D. funds were used to reimburse banks for lending that had occurred in the past --and in some cases distant past. This was accomplished by changing the word **will** (submit planned incremental lending) to **may** (submit planned incremental lending) and redefining the word **new** to mean loans made after July 24, 1990, the date the agreement was signed with the GOP.

In summary, the Mission bypassed the single control technique established in the program design and expressly set forth in the authorization document. To accomplish this the Mission: (1) weakened the authorization document criteria when they prepared the agreement by changing the word "will" to "may", (2) redefined the word "new" (loans made on or after July 25, 1990 were considered new even as late as March 1992--the date of this report), and (3) implemented the agreement as though this single word change negated the entire remainder of this section, (quoted on the preceding page vii) which discusses the prior submission, review, and approval of planned loans that established the control technique.

Panama banking secrecy laws prohibit A.I.D. or any U.S. Government audit organization from determining the date of the actual loans used to support a claim on A.I.D. funds through the sale of ICDs. Accordingly, we do not know (nor does A.I.D.) the date of most loans used to obtain A.I.D. funds[3]. We do know these loans were made prior to the banks applying for A.I.D. funds, and that banks did not submit planned loans for prior review and approval. We also know that under

[3] Some banks voluntarily provided us with information on certain loans during our prior audit. See report No. 1-525-91-014, pages 23-27.

the implementation methods USAID/Panama is using, loans made as long ago as July 25, 1990 can still be considered as new loans and thereby currently serve as a basis for banks to receive A.I.D. funds. USAID/Panama is aware of and considers all of the above to constitute a valid basis for its implementing agency to disburse A.I.D. funds under the second phase of this program.

Did A.I.D. increase credit to the private sector development? USAID/Panama believes the answer is yes and supports this belief through macroeconomic analysis. We know only that due to the methods USAID/Panama chose to implement this program, no audit techniques are available that can link even a single dollar of the $107.9 million to an increase in credit to private sector development. We can determine only that liquidity to the multibillion dollar Panama Banking System was increased by $107.9 million of A.I.D. funds. Did A.I.D. follow through with its congressional notification on reactivating the private sector development? A.I.D. refers to macroeconomic analysis to answer in the affirmative. We found no empirical evidence that this occurred.

The complete text of USAID/Panama's comments are attached to this report as Appendix II.

Office of the Inspector General

Office of the Inspector General
March 30, 1992

INTRODUCTION

Background

Following the U.S. military activity which took place in Panama in December 1989, the Congress took up the issue of emergency assistance for Panama in January 1990. The President signed into law "The Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act" (Act), Public Law 101-302, on May 25, 1990, which included $420 million of new economic assistance for Panama. The Act and associated Congressional committee reports intended the $420 million to:

- assist and encourage the Government of Panama in taking the necessary steps to enable the proper functioning of a market economy and a political democracy,

- encourage the Government of Panama to reach agreements on exchange of records on international currency transactions in connection with narcotics investigations and towards signing a Mutual Legal Assistance Treaty, and

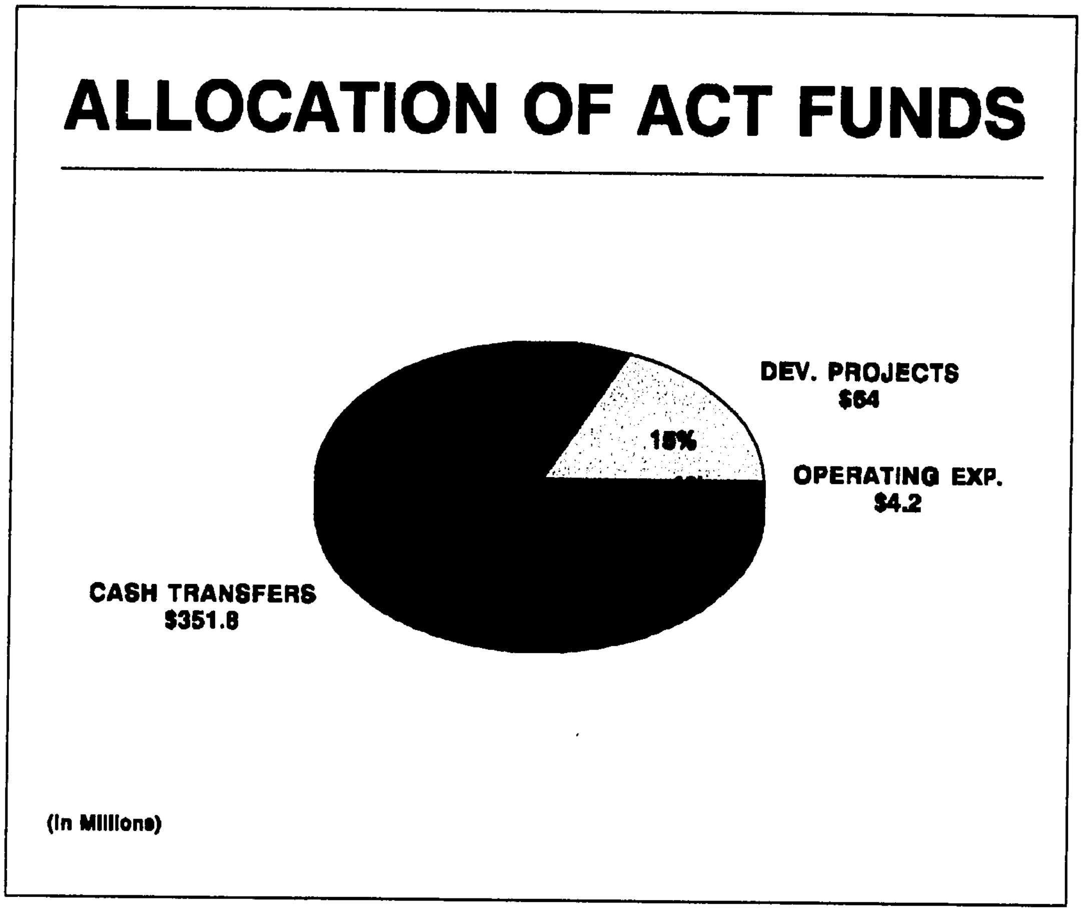
- provide assistance in such areas as police services, environmental protection, child survival, health, education, private sector development, and budget support.

To accomplish these tasks, USAID/Panama designed and developed the Panama Assistance Program (Assistance Program) consisting of cash transfer assistance and development projects. The majority of the funding, $351.75 million, was budgeted for two cash transfer programs. The first, the Economic Recovery Program, includes two major subprograms. One subprogram consists of a $130 million payment to help Panama clear its arrears to the International Monetary Fund, the World Bank, and the InterAmerican Development Bank. The other subprogram earmarks $113.85 million as budgetary support for justice, education, health, and other public sector activities including infrastructure repairs and improvements. This first cash transfer program included significant conditions which Panama was required to meet prior to disbursal of the funds.

The second cash transfer program, the Private Sector Reactivation Program, was funded at $107.9 million. This program also has two phases. The first was to provide short-term liquidity support for private Panamanian-owned banks through rediscounting of quality commercial paper under short-term repurchase agreements. The second was to rediscount new production, working capital, and investment loans for the private sector.

In addition to the cash transfer programs, by November 30, 1991, $64 million of Act funds had been obligated for 19 development projects. Three of these projects were ongoing and received an additional $6.45 million from Act funds and three other projects, funded at $13.8 million, were the management responsibility of other U.S. Government entities. A.I.D./Washington transferred the funds to those entities.

The following graph shows the allocation of the $420 million of Act funds as of November 30, 1991.



The Act requires the A.I.D. Inspector General to, "... at least semiannually, beginning six months from the date of enactment of this Act, audit the Economic Support Fund programs provided under this Act for Nicaragua and Panama to assess the financial management and administrative systems established by the Agency to control such programs..." A Congressional committee report accompanying the Act states the intention that this special auditing requirement will be applicable only through fiscal year 1991. This audit responds to the requirement established in the Act and presents the results of our third and final semiannual internal audit covering Assistance Program activities through November 30, 1991.

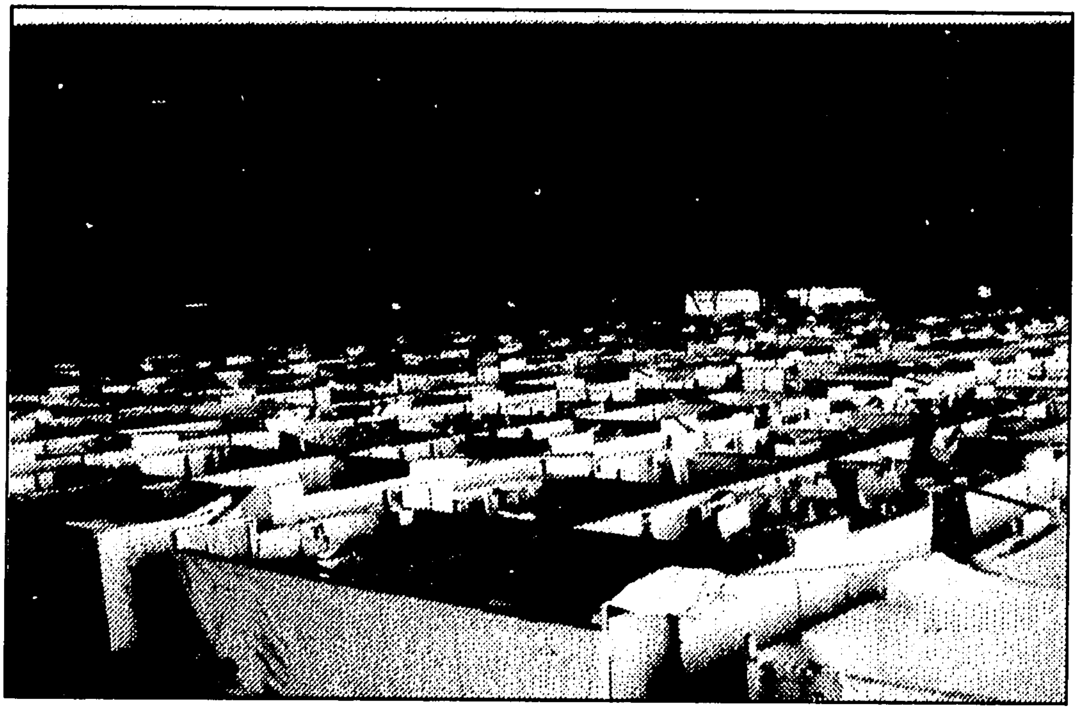
Audit Report No. 1-525-91-005, dated February 8, 1991, covered the first six months (May 25, 1990 through November 30, 1990) of the Assistance Program's implementation. That internal audit provided our preliminary assessment of vulnerability for each program and project activity based upon the actual or planned controls to be incorporated into the agreements with external implementing entities.

Audit Report No. 1-525-91-014, dated September 12, 1991, was our second semiannual audit covering Assistance Program activities through May 31, 1991. That internal audit examined whether A.I.D. designed the Assistance Program to meet the requirements of the Act and additional Congressional guidance and whether it followed its policies and procedures in implementing, monitoring, and accounting for Assistance Program activities. With regard to whether USAID/Panama followed A.I.D. policies and procedures that audit emphasized the planning aspects of both cash transfer assistance and development projects. The implementation aspects of each category of assistance were reviewed as well, but limited progress had been made at that point in time for the activities within the scope of our review.

Appendix III shows the status of issues raised by our first two audits that remained unresolved at the beginning of the current audit period. In addition to our internal audits cited above, during the period we issued two Mission-funded financial audit reports of Assistance Program activities and a third was in the draft stage at the end of our audit period.

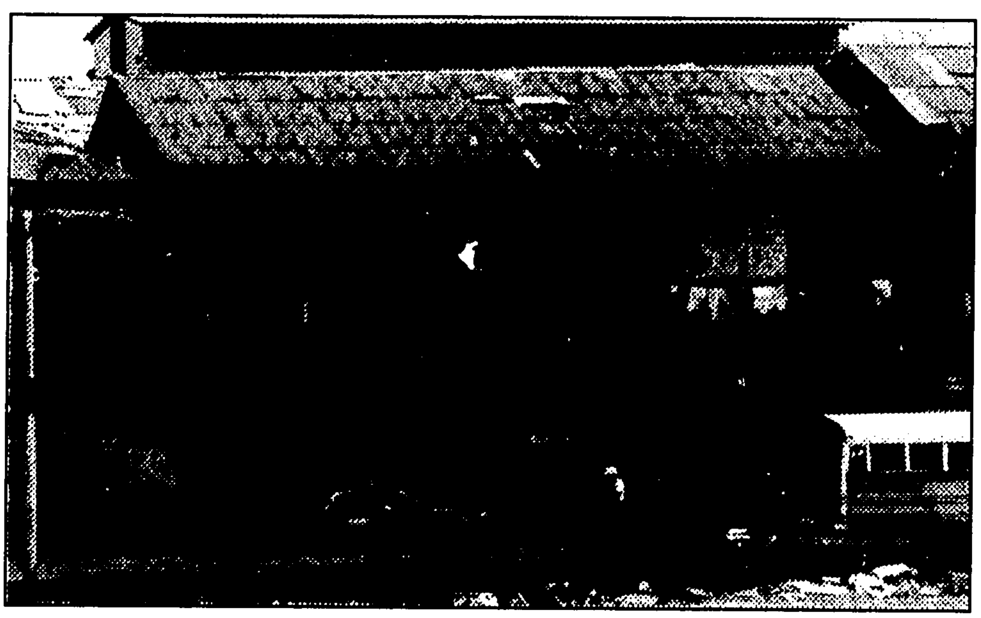
Audit Report No. 1-525-92-06-N, dated November 15, 1991, was a review of the food and shelter assistance under the Immediate Recovery Project. The audit period was from July 16, 1990 to June 30, 1991, and the audited amount was $1.73 million.

The audit noted certain inherent limitations which arose at the time the assistance began which persisted during the audited period. However, in the opinion of the auditors, these conditions did not have a material financial impact on the project given the circumstances. The auditors found that the fund accountability statement for the assistance was fairly presented and did not note any material internal control weaknesses or instances of noncompliance with laws, regulations, or agreement terms. The photograph on the top of page 4 shows the food and shelter facility erected in a hanger at Albrook Air Force Base as one of the solutions to the emergency needs met by this project.

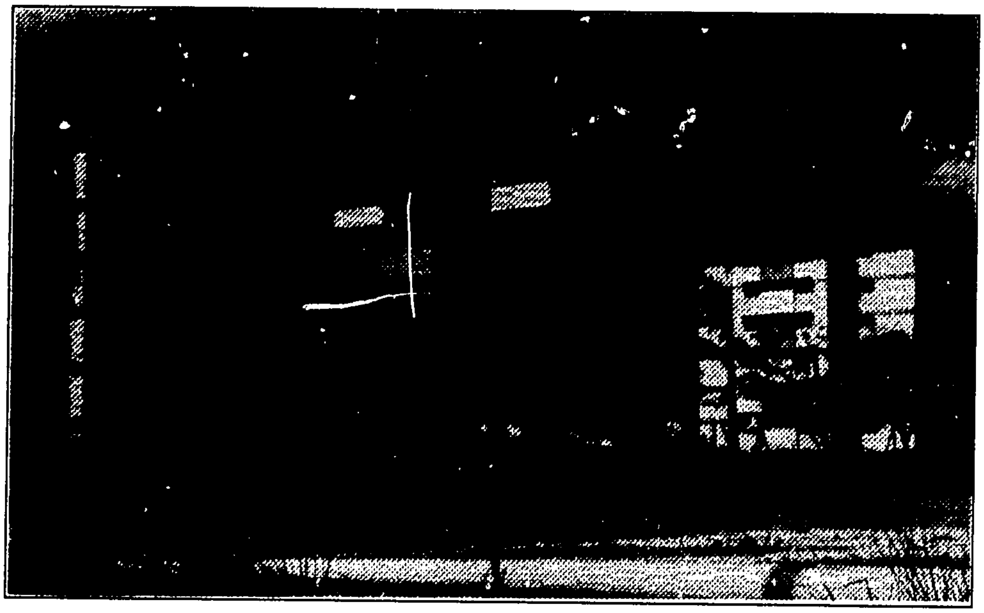


A food and shelter facility at Albrook Air Force Base, Panama

Audit Report No. 1-525-92-07-N, dated November 15, 1991, reviewed the housing assistance under the Immediate Recovery Project and covered expenditures of $13.4 million including about $1.7 million of Act funds. The auditors found: the fund accountability statement was fairly presented, no material internal control weaknesses, and no instances of noncompliance with laws, regulations, or agreement terms.



Housing in Chorrillo, Panama before Immediate Recovery Project construction began



New housing in Chorrillo resulting from the A.I.D. Immediate Recovery Project

The third audit in draft was a review of Assistance Program expenditures[4] which could be verified from records available in Panama. The audit period was from May 25, 1990 to September 30, 1991, and the amount audited was $147 million ($146.9 million which pertained to USAID/Panama's two cash transfer programs and the remainder to one development project which had its official accounting records in Panama).

Audit coverage of the cash transfer assistance was limited to reviewing the support for the expenditures of dollars from the Federal Reserve rather than the final use of the funds in Panama. As previously reported in our first two internal audits, A.I.D. designed the programs so the funds could only be tracked to an intermediate level--not the final end use.

For this third audit, the auditors found that the fund accountability statement for the audited funds was fairly presented except for $2,886 of questioned costs. However, the auditors noted as a "subsequent event" the repayment of $5.1 million by participating banks to this program as a result of reviews by Panama's National Banking Commission which found the associated loans did not qualify under the program. Because of Panama's bank secrecy laws, the auditors themselves were not

[4] Except those expenditures for the Immediate Recovery Project which were reviewed by other auditors.

able to review actual loan documentation at participating banks. The auditors also found certain internal control and noncompliance issues with regard to both the Private Sector Reactivation Program and the one development project audited.

The Department of Justice Inspector General (DOJ/IG) was also conducting an internal audit during this reporting period. We had requested the DOJ/IG to audit $13.2 million of Act funds transferred to the DOJ to implement the Improving Police Services Project. The DOJ/IG reviewed the financial management and administrative systems used by the DOJ implementing entity and also reviewed direct and indirect costs of the project's primary contractor. The DOJ/IG had not issued its report by the end of our audit period.

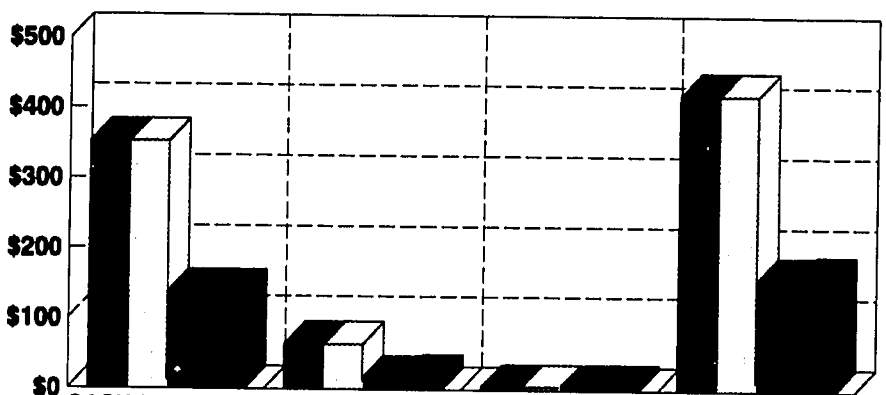
Finally, in May 1991 the Government of Panama's Controller General, as required by the agreement for the Economic Recovery Program, contracted a financial review of the Special Priority Investment Fund (SPIF) account, an account established under the program to support the Government of Panama's public investment budget. The contract with a local accounting firm required quarterly reports. The first quarterly report, covering the period July 3, 1990 through September 30, 1991, was a management letter rather than a normal financial review report. A report could not be prepared because the information provided to the accounting firm by the Government of Panama agencies receiving funding was late, inaccurate, and incomplete and thus not adequate for the preparation of a financial review report. It was intended that this financial review would identify any problem areas warranting appropriate corrective action. Because of the mentioned problems there was no independent verification that SPIF funds were being used for the purposes intended by the agreement.

The present audit examines whether A.I.D. implemented its cash transfer assistance under the Assistance Program in accordance with program authorization documents and agreement terms and whether A.I.D. established and maintained financial and administrative systems to ensure that development project activities were implemented in accordance with A.I.D. policies and procedures. Since USAID/Panama has primary responsibility for implementing the Assistance Program, the audit answers the above questions in terms of the Mission's management of the Assistance Program.

As we reviewed USAID/Panama's compliance with A.I.D. policies and procedures for cash transfer assistance during our second semiannual audit, our audit objectives for cash transfer assistance for this reporting period were chosen to inform A.I.D. and the Congress of our observations regarding the status of each cash transfer program and issues that remained as of our audit cut-off date. We retained an audit objective for development projects to review compliance with A.I.D.'s policies and procedures. A.I.D. has more detailed procedural guidance for development projects regarding the provision of project inputs (e.g. technical assistance, commodities, participant training). Further implementation progress since our last audit provides some basis to review A.I.D.'s compliance with those procedures.

As of November 30, 1991, the Mission had obligated the $420 million of the Act's funds and had accrued expenditures totaling $159.8 million[5]. According to unaudited financial information gathered during the audit, the following graph summarizes the financial status of the Assistance Program in Panama.

UNAUDITED FINANCIAL STATUS
PANAMA ASSISTANCE PROGRAM
THROUGH NOVEMBER 30, 1991



	CASH TRANSFER	DEVELOPMENT	OPERATING	TOTAL
BUDGETED	$352	$64	$4	$420
OBLIGATED	$352	$64	$4	$420
DISBURSED	$138	$16	$4	$158
EXPENDED	$138	$18	$4	$160

■ BUDGETED □ OBLIGATED ■ DISBURSED ■ EXPENDED

(In Millions)

Appendix IV provides a financial summary of Assistance Program activities as of November 30, 1991, and Appendix V provides the status of individual projects.

[5] Total accrued expenditures through January 31, 1992 were $331.8 million.

Audit Objectives

The Office of the Regional Inspector General for Audit/Tegucigalpa audited A.I.D.'s systems for managing the Assistance Program funded by the Act to answer the following audit objectives.

1. Did A.I.D. implement the cash transfer assistance under the Economic Recovery Program in accordance with program authorization documents and agreement terms?

2. Did A.I.D. implement the cash transfer assistance under the Private Sector Reactivation Program in accordance with program authorization documents and agreement terms?

3. Did A.I.D. establish and maintain financial and administrative systems to ensure that development project activities were implemented in accordance with A.I.D. policies and procedures?

Our fieldwork to answer these objectives was conducted at USAID/Panama and its accounting station USAID/Costa Rica. Therefore, we have answered the objectives mainly in terms of the conditions noted at these A.I.D. field Missions. While we did not consider it necessary to conduct fieldwork in A.I.D./Washington, this report includes references to A.I.D./Washington's role in the Assistance Program to the extent that was verifiable from official documents or supported by interviews with Mission management.

In answering the audit objectives, we tested whether A.I.D. (1) followed applicable internal control procedures and (2) complied with certain provisions of laws, regulations, and agreements. Such tests were sufficient to provide reasonable, but not absolute, assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. However, because of limited time and resources we did not continue testing when we found that, for the items tested, A.I.D. followed its procedures and complied with legal, regulatory, and agreement requirements. Therefore, we limited our conclusions concerning these positive findings to the items actually tested. But when we found problem areas we performed additional work to:

- determine that A.I.D. was not following a procedure or not complying with an A.I.D. policy,

- identify the cause and effect of the problem noted, and

- make recommendations to correct the condition and cause of the problem. Appendix I contains a complete discussion of the scope and methodology for this audit.

REPORT OF AUDIT FINDINGS

Did A.I.D. implement the cash transfer assistance under the Economic Recovery Program in accordance with program authorization documents and agreement terms?

USAID/Panama implemented the cash transfer assistance under the Economic Recovery Program in accordance with program authorization documents and agreement terms. The program, however, had not been implemented within the planned timeframe.

The program's purpose according to authorization and agreement documentation was to provide $243.85 million to support the Government of Panama in implementing policy reforms for economic recovery and to help restore the credit worthiness of the Panamanian public sector.

USAID/Panama ensured that the requirements specified in the program's authorization documents were incorporated into the agreement including disbursement of A.I.D. funds based on the Government of Panama's commitment to and implementation of a policy reform program. USAID/Panama enforced agreement terms by not disbursing the initial $29.85 million tranche until required conditions were met and withheld further disbursements pending the GOP's final agreement with international financial institutions.

USAID/Panama implemented this cash transfer program in accordance with program authorization documents and agreement terms. However, we are reporting certain unforeseeable events which precluded final disbursements from being made during the planned timeframe. This condition is discussed below. Further disbursements took place after our audit cut-off date and we are reporting that information.

Funds Provided Under The Economic Recovery Program Had Not Been Disbursed As Quickly As Planned

The Economic Recovery Program had not been implemented as quickly as planned. Program design documents anticipated that total funding of $243.85 million would be disbursed within nine months--by March 1991. However, as of November 30, 1991, seventeen months after the program began, only $29.85 million, or 12 percent of the funds, had been disbursed by A.I.D. This $214 million short-fall in disbursements ($130 million to clear the debt arrearages of the Government of

Panama (GOP) with international financial institutions (IFIs) and $84 million to support the GOP public sector investment budget) happened because the GOP had not implemented policy reforms required by the agreement in support of the IFIs. These policy reforms and clearage of debt arrears to the IFIs were required before the IFIs would make further loans to the GOP. Therefore, the lack of these reforms was blocking further resource flows both from the IFIs and A.I.D. While at the time of our audit cut-off date it was uncertain whether the GOP would implement some of the policy reforms required by the IFIs, breakthroughs occurred since that date and A.I.D. has released all but $42 million. However final implementation of some policy reforms has yet to be completed. Since A.I.D.'s management of the program has effectively supported the IFIs in making progress on the desired policy reforms we are making no recommendations.

The Economic Recovery Program has two subprograms. One was funded with $130 million to help Panama clear its debt arrears to normalize its relations with IFIs--the International Monetary Fund (IMF), the World Bank (IBRD), and the InterAmerican Development Bank (IDB). The other subprogram earmarked $113.85 million to support the GOP's public sector investment budget for priority investments in agriculture, health, education, justice, other social sectors, natural resources and infrastructure. This cash transfer program included significant conditions precedent (CPs) under each subprogram which the GOP was required to meet prior to the disbursal of funds. The status of each subprogram and its conditions precedent follows:

Subprogram to Normalize Panama's Relations with the IFIs

The conditions precedent to disbursement for the IFIs subprogram required the GOP to: a) adopt a short-term economic stabilization program that meets the requirements for a stand-by program with the IMF, b) provide a letter stating it has set aside $130 million as Panama's contribution to clear its arrears, c) provide evidence that no additional arrearages to the IFIs have accumulated beyond those payments overdue as of December 31, 1989, and d) provide evidence that the Panama Support Group (a group of international donors formed to assist Panama in normalizing its relations with IFIs) has identified sources of funding sufficient to repay the full amount of Panama's arrearages with the IFIs.

Condition Precedent a) - Condition precedent a) was to adopt a short-term economic stabilization program that meets the requirements for a stand-by agreement. In September 1990 the IMF prepared a Fund-Monitored Program which endorsed the GOP's plan to restore private sector confidence, foster economic recovery, strengthen public finances, and reestablish relations with external and domestic creditors. Structural reforms in the areas of trade, labor regulations, price liberalization, and the public sector were the main thrusts of this program. In its latest review of the Fund-Monitored Program in September 1991, the IMF reported satisfactory performance by the GOP.

The IMF was optimistic that a stand-by agreement could be reached quickly. However, the actual signing of the stand-by agreement with the IMF depended upon the GOP first reaching an agreement with the World Bank.

Negotiations with the World Bank started in mid-May 1990 when a mission from the World Bank visited Panama and left a policy agenda for GOP consideration. Intense negotiations followed between the World Bank and the GOP. The parties estimated that an agreement could be negotiated by March 1991 and approved by the World Bank's Board of Directors in June 1991. Despite the GOP's efforts to reach an agreement, the negotiations took longer than anticipated due to public sector institutional weaknesses, the GOP's inability to obtain a consensus on its reform program, and the complexity of the agreement which required the GOP to outline the process of how it will implement and reach the agreed upon reforms.

Among other things, the World Bank had required the GOP to implement policy reforms in the areas of income tax, social security and privatization. The GOP's Letter of Development Policy noted the need for the passage of laws in these areas before any new agreements could be reached with the IFIs. The corresponding bills for these reforms were drafted and submitted to the Panamanian Legislative Assembly.

A.I.D. management has effectively supported the IFIs in making progress on the desired policy reforms.

At our audit cut-off date these bills had not been passed; however, the bills for social security and income tax were subsequently passed on December 26 and December 31, 1991 respectively. As of January 1992, the privatization bill still had not passed as it was part of a package of pending legislation and Panama's Assembly was in recess until March 1, 1992. In order to avoid further delays in the arrearage clearance process, the World Bank agreed to remove its requirement for policy reform in the privatization area. This area has been the major interest of the InterAmerican Development Bank (IDB). While there still is agreement in principle between the IDB and GOP in the privatization area, the IDB has decided not to sign its agreement with the GOP until the privatization law is passed. The GOP has set aside funds to clear its arrears with the IDB.

The World Bank agreement will start the process for Panama to clear its arrears with the IFIs with funds from A.I.D.'s cash transfer program ($130 million), Panama's own contribution ($262 million), a U.S. Treasury Bridge Loan (up to $150 million), and the Support Group contribution from Japan, Taiwan, and France ($93 million).

<u>Condition Precedent b)</u> - Condition precedent b) required the GOP to provide a letter stating that it had set aside $130 million as its contribution to clear IFI arrearages. On August 28, 1990 this condition precedent was met when the GOP's Minister of Planning certified that the GOP has assigned $130 million in its 1990 budget for IFI arrearage payments. According to USAID/Panama and U.S. Treasury officials, the GOP had set aside and made readily available $262 million from its own resources for the payment of Panama's debt arrears to the IFIs ($130 million deposited in the Federal Reserve Bank of New York and $132 million deposited in the National Bank of Panama). The extra $132 million was to be used to clear further arrearages that the GOP allowed to accumulate after the December 31, 1989 date specified in the agreement and to make up any shortfall of contributions from the Support Group.

<u>Conditions Precedent c)</u> - Condition precedent c) required the GOP to provide evidence that no additional arrearages to the IFIs accumulated beyond those payments overdue as of December 31, 1989. The GOP had not complied with this condition precedent. It decided not to pay the January, February, and March 1990 IFI obligations estimated to be as much as $62 million but instead to include these payments as part of the total arrearages being negotiated with the IFIs. Total IFI arrearages thus increased from $539 million to about $620 million. Although the GOP had not made the January to March 1990 payments, it has reserved funds to cover these additional arrearages. USAID/Panama accordingly amended the agreement's condition precedent changing the cut-off date for no further arrearages from December 31, 1989 to March 31, 1990. This condition precedent was met on August 28, 1990, when the GOP's Minister of Planning sent a letter to USAID/Panama stating that since April 1990 the GOP had made all required IFI payments equivalent to monthly maturity of capital and interest.

<u>Condition Precedent d)</u> - Condition precedent d) involved financial assistance from the Panama Support Group. The U.S. Treasury representative to the Support Group informed us on December 5, 1991 that the process for depositing the contributions of the GOP and other donor countries into separate accounts at the Federal Reserve Bank of New York had been initiated. About $93 million had been identified at our audit cut-off date as contributions from Japan ($50 million), Taiwan ($40 million) and France ($3 million).

Subsequent to the completion of our audit cut-off date the Mission in a letter dated January 28, 1992, acknowledged that the GOP had met all conditions precedent to the disbursement of the $130 million to be used to clear IFI arrearages. This amount was transferred to a separate account in the name of the GOP at the Federal Reserve Bank of New York on January 29, 1992.

Subprogram for Support for the **GOP's Public Investment Budget**

The $113.85 million assistance under this subprogram was to be disbursed in three tranches of $29.85 million, $42 million and $42 million respectively. Each tranche had its own conditions precedent. The GOP met the conditions precedent to disbursement of the first tranche on October 17, 1990, and A.I.D. disbursed the $29.85 million to a separate account at the Federal Reserve Bank of New York four days later. As of August 31, 1991, the $29.85 million had been withdrawn from the separate account and deposited into a commingled Special Priority Investment Fund (SPIF) account at the National Bank of Panama. This money was to be used for the funding of activities under the GOP's public sector investment budget.

In addition to A.I.D.'s contribution, the GOP had deposited in the SPIF account $21.5 million as its counterpart. As of November 30, 1991, a total of $39.85 million of the $51.37 million deposited in this account had been used to finance public sector investment activities.

The grant agreement required the GOP's Controller General to conduct an independent financial review of disbursements out of the SPIF account. The accounting firm Peat Marwick, Mitchell and Co. was contracted in May 1991 to conduct this review. The scope of work required this firm to provide quarterly reports. The report covering the period July 3, 1990 to September 30, 1991 consisted of a management letter rather than the normal financial report because **the information provided to Peat Marwick by the GOP agencies receiving funding was late, inaccurate, and incomplete and thus not adequate for the preparation of a financial review report. Therefore, as of that date there was no independent verification that SPIF funds were being used for the purposes intended by the agreement.** It was intended that this financial review would identify any problem areas warranting appropriate corrective action.

The disbursement of the second and third tranches was delayed because of the lack of agreements between the GOP and the IFIs. The conditions precedent to disbursement of the second tranche states that the GOP must provide evidence that it has: a) reached an agreement on a medium-term economic reactivation program supported by the World Bank and the IDB, b) made acceptable progress in implementing policy reforms, and c) reached and agreement with the U.S. for exchanging records on international currency transactions in connection with narcotics investigations and is making steady progress towards signing a Mutual Legal Assistance Treaty.

According to USAID/Panama the actions taken by the GOP to date--namely, the GOP's Letter of Development Policy, the agreement in principle with the IFIs, the bills passed or proposed to the GOP Assembly, and the signing of a Mutual Legal Assistance Treaty--are sufficient for the disbursement of the agreement's second tranche. The second tranche had not been released by our audit cut-off date because the GOP had not requested it.

Subsequently the Mission in a letter to the GOP dated January 15, 1992 acknowledged the GOP's meeting all conditions precedent to the disbursement of the second $42 million tranche and accordingly this amount was transferred to a separate account at the Federal Reserve Bank of New York for the GOP on the following day.

Did A.I.D. implement the cash transfer assistance under the Private Sector Reactivation Program in accordance with program authorization documents and agreement terms?

USAID/Panama did not implement the cash transfer assistance under the second phase of the Private Sector Reactivation Program in accordance with program authorization documents and agreement terms because the agreement did not include the Program Assistance Approval Document (PAAD) provision which would have established a link between the program funds and lending to reactivate Panama's private sector. Also, the agreement, as written, was somewhat vague. We believe it nonetheless still gave the Mission leeway to insist upon the linkage as established in the PAAD. The Mission, however, elected not to choose this course of action.

Except for the provision noted above, the Mission negotiated a program agreement which followed the design approved in authorization documents. It did not incorporate the provision because it considered the provision--to require banks to submit a plan for prospective new lending and to disburse the program's funds when that lending occurred--would lead to unacceptable delays in disbursing the assistance. It considered the program's purpose was mainly to add liquidity to Panama's banking system, and to this end it fully disbursed the funds. The extent, if any, that these funds led to private sector reactivation is not known.

The Mission does not know if the banks that received the program's funds used the money for incremental lending of the type the program was meant to support. It believed that the private sector reactivation objective was achieved merely by providing program funds based upon the banks' past lending activities if they occurred subsequent to the agreement date. In response to our last audit the Mission funded an evaluation of the program which concluded that the program was a success because the overall loan levels for banks participating in the program increased by more than the program funds received. The Mission claimed that the evaluation clearly supported the need for the program.

Our view of the program differs from the Mission's in several respects. First we consider that, as authorized by the LAC Bureau, the primary purpose for this phase of the program was to support incremental new lending that contributed to Panama's economic recovery --not merely to introduce liquidity into Panama's banking system by substituting program funds for loans the banks had already made without regard to the program. We believe that the lack of a direct link between the program's funds and incremental new lending which was expected to occur as a result of the program to be a fundamental flaw in the implementation of the program.

Second we disagree that implementing the program as authorized would have or would now result in unacceptable delays. The Mission's view stems from its conception that the liquidity aspect of the program is its primary purpose. If incremental new lending is the primary purpose, no delay would be introduced.

Third, we disagree with the Mission's interpretation that the Mission-funded evaluation of the program clearly supported the need to continue the program. In our opinion the evaluation's results were inconclusive because the program funds substituted loans previously made by the banks, and there is no way to tell whether the banks used the additional liquidity for further lending of the types that the program was meant to support. Due to Panama's bank secrecy laws, A.I.D. is unable to directly verify the workings of the program at participating banks, and we consider this to be a major design weakness.

The issues above are included in our presentation of two problem areas under the following captions:

- The Private Sector Reactivation Program Was Not Being Implemented as Authorized

- The Private Sector's Need For More Program Funds Should Be Determined

The Private Sector Reactivation Program
<u>Was Not Being Implemented As Authorized</u>

To address the need for reactivating the Panamanian private sector, A.I.D.'s authorization documents provided that participating banks were to submit plans for their incremental lending which, if approved and executed, A.I.D. funding of 50 percent would be provided through the purchase of interbank certificates of deposit (ICDs). We found that the authorization document provision for a lending plan was dropped as a prerequisite for the purchase of ICDs in the agreement and accordingly such plans were not submitted. Subsequently an Operations Manual was developed which provided that loans taking place since the signing of the agreement (July 24, 1990) would be eligible as a basis for the purchase of ICDs.

These changes led to the entire $107.9 million under the program being disbursed based on past versus prospective lending activity. There was no way to assess whether the participating banks would have made the loans anyway in the absence of the program, nor was there a way to determine whether the banks actually used the additional liquidity to increase lending for the types of activities the program was meant to support. No alternative mechanism was developed to show that new lending would take place as a result of the program as opposed to simply reimbursing banks for old lending. Considering that repayments of ICDs can be used to purchase additional ICDs, the Mission should require the submission of lending plans as provided in the authorization documents.

<u>Recommendation No. 1:</u> **We recommend that USAID/Panama:**

1.1 **amend the program grant agreement to include the requirement for participating banks to submit a plan of their intended incremental lending activities for review and approval and for the program's funds to be disbursed when the planned lending takes place; and**

1.2 **unless resolved, report the lack of linkage between the program and incremental new lending in its next assessment of internal controls.**

On July 16, 1990, the A.I.D. Assistant Administrator for Latin America and the Caribbean Bureau approved the Private Sector Reactivation Program and authorized the obligation of $107.9 million of Act funds.

The purpose of the program as stated in the Congressional Notification was to assist the Government of Panama (GOP) to: (1) reactivate the banking system, and (2) increase credit to the private sector in Panama. The first purpose was to provide immediate liquidity to Panama's banking system in the event that a "run" on the banks would occur as a result of lifting deposit withdrawal restrictions. The "run" on the banks did not occur so all the funds were disbursed for the second purpose. The justification for the credit expansion subprogram as stated in the action memorandum authorizing the program was:

> Banks that **plan to expand** [[6]] their medium and long term productive loan portfolios **will** submit to the National Bank of Panama (BNP) **evidence of additional productive lending planned to occur within a thirty day period.** Loans will be for investments in new plant and equipment, for construction, for mortgages for newly constructed buildings or for incremental working capital. After the BNP determines that the portfolio addresses the types of lending desired, it will agree to

[6] All bolding in this quote has been added for emphasis.

> purchase certificates of deposit in an amount equal to one half of the value of the lending packages. The purchase of certificates of deposit will take place **after** the private bank provides **evidence of new medium and long term lending.**

In proposing this program for review and approval, the Program Assistance Approval Document (PAAD) stated:

> Banks that **plan to expand** [[7]] their medium and long-term portfolios **will** submit to the BNP a description of the **incremental lending they plan to make** within the next 30 days.

The A.I.D./Washington committee which reviewed the PAAD was concerned about whether A.I.D. funds could be tracked to and would finance specific loans. The Mission explained that individual loans would not be reviewed. Instead, prior to purchasing ICDs the implementing agency would review bank **plans to expand** productive lending and **actual expansion** of lending to ensure banks had demand for **more lending** and to establish an appropriate maturity period for ICDs.

The action memorandum, the PAAD and the Mission's clarification to the A.I.D./Washington review committee clearly established that the purchases of the ICDs would take place after the participating banks submitted to the BNP a proposed plan for the new incremental lending activities and after the banks provided evidence that they had made the loans specified in the plan.

Contrary to the justifications made in obtaining authorization for the program, in its agreement with the GOP the Mission did not specifically require banks to submit a plan for incremental lending activities. Instead the grant agreement states:

> Banks that **plan to expand** [[8]] their medium and long-term portfolio (loans between one and five years) **may** submit to the BNP a description of such **incremental lending that they plan to make** in the next thirty days. **The proposed...lending** must be for investments in plant and equipment for new project activity, construction, mortgages for newly constructed buildings, or for incremental working capital. If the **proposed increase** in medium and long-term portfolio meet the requirements of the program, BNP will agree to purchase interbank certificates of deposit from the PB [[9]] equal to one half of the value

[7] All bolding in this quote has been added for emphasis.

[8] All bolding in this quote has been added for emphasis.

[9] Participating bank

of the **subsequent actual new** [[10]] medium and long term credit extended by the PB... The purchase of ICDs **will take place after the PB submits documentation**...evidencing the **actual increase in new** medium and long-term lending....The PB, at any time after submitting their **proposal** to the BNP and after making **formal credit commitments increasing its portfolio** of medium and long-term credit, will submit documentation to the BNP...of such **new credit** with certification that it conforms to the criteria established for the program. On this basis, the BNP will purchase ICDs....

While the change of the word "will" in the authorization documents to "may" in the agreement would not appear significant given that the remainder of the text indicates the program was designed to support approved incremental new eligible lending activities, in fact **the interpretation given to it by the Mission established a sharp departure.**

Plans for new lending activities were not required and the linkage between the program and new eligible lending was lost.

The Mission's position was that the change completely did away with the requirement for banks to submit a plan for new loans. Thereafter, the Mission permitted the National Bank of Panama to use an Operations Manual which significantly deviated from the agreement. Specifically, the Operations Manual defined "new lending" as any loan made by the PBs which occurred after the date the project agreement was signed (July 24, 1990). Additionally, it did not require PBs to submit a description of the incremental lending they planned to make in the next 30 days, and it did not require the purchase of ICDs from these banks based upon implementation of this planned lending activity.

The Mission indicated that the agreement language used ("will" changed to "may") was a conscious decision after conducting extensive interviews with bankers and a "reality check" analysis was performed. According to the Mission this analysis showed that it could take up to four months to process a loan, mainly due to the process of recording a lien on the collateral, which the Mission considered to be an unacceptable length of time.

The Mission could provide no written evidence of the interviews or analysis it said supported its decision, and its analysis is based upon pumping money into Panama's banking system rather that supporting new lending for productive activities to

[10] See footnote 8, p.17.

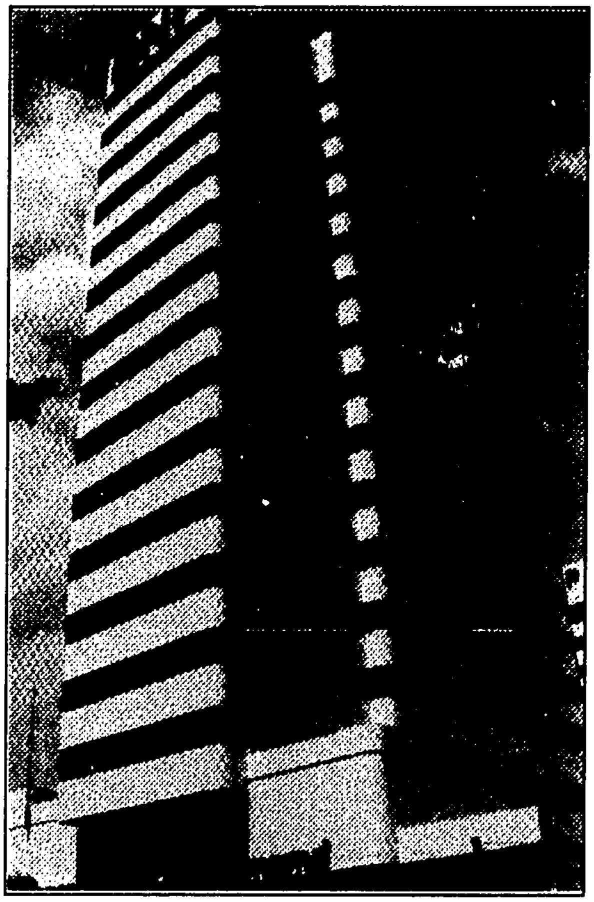
reactivate Panama's economy. The only time to be saved would be that time waiting for the new loans to be made. In any case, the rate of disbursement of the program's funds would only be temporarily affected by waiting for planned lending activity to take place, because the banks would have an ongoing flow of loan applications which they could submit under the program at the point of starting the process to record the lien. The funds would then be committed under the program to provide to the banks when the banks themselves were ready to disburse.

The result of the above changes, introduced at the agreement stage, is that the linkage between the program and incremental new lending as a result of the program has been lost. All of the participation in the program has been based on past lending activity versus prospective lending activity. Had the program been implemented as planned, a linkage would have been established between program funds and new lending activity contributing to the reactivation of the Panamanian private sector. However, without that linkage there is no way to assess whether the participating banks would have made the loans anyway in the absence of the program. Further, since the banks made the loans prior to applying for program funds it is clear that the program's funds were not used for those particular loans. Because of Panama's bank secrecy laws and the fact that the agreement did not require the banks to maintain separate accounts which would have documented their actual use there is now no means for A.I.D. to determine whether the banks used program funds for the types of activities the program was meant to support.

Although the agreement did not specifically define "new lending", it is implied from the criteria previously discussed that new credit would result after the bank declared its intention to participate in the program and proposed plans for new lending activities were carried out. The program agreement and the Program Assistance Approval Document contain the following specific criteria for participating banks:

> Before entering into any transaction under the program, the participating banks (PBs) will sign the legal documents designed by the GOP [the National Bank of Panama (BNP)--the GOP's implementing agent] for participating in this program and will adhere to the regulations laid out in the corresponding Operations Manual.

On August 29, 1990, the BNP through the National Banking Commission--the GOP's regulatory entity for the Panamanian banking system--required all the banks planning to participate in the program to provide the BNP the names and signatures of the authorized officials who would be requesting program funds and the bank's account number where the approved funding would be transferred. Twenty-eight banks responded at different dates (ranging from September 21, 1990 to July 9, 1991) declaring their intention to participate in the program.



Headquarters of the National Bank of Panama which, as the implementing agent for A.I.D.'s Private Sector Reactivation Programs, managed $107.9 million in Program funds. A.I.D. does not know if or to what extent the funds were used for reactivation of the private sector development.

We determined the dates of the loans submitted by the PBs to the BNP for the purchase of ICDs. Comparing these dates, we found that the BNP purchased ICDs totalling about $21.8 million based on loans made by 17 PBs prior to the banks declaring their intention to participate in the program. For example, one bank used 37 loans made prior to its providing the BNP with the information required by the National Banking Commission to support $8.6 million in ICD purchases. Clearly, loans made prior to a bank's declaring its intention to join the program were made regardless of the existence of the A.I.D. program.

A further indication that the program was not linked to new lending activities was identified by our review of the October 1991 PB requests. We found that the statistical information submitted by banks indicated that certain loans had been made by the banks more than a year earlier (August 9, 1990). Although meeting the parameters of the Operations Manual, it is highly questionable whether year-old loans could be categorized as new incremental lending activity which occurred due to the program. It is more likely that the banks were using program funds to substitute for loans they made without regard to the program.

Panama's National Banking Commission (CBN) (the only entity authorized access to all the banks operating in Panama) reviewed the PBs' compliance with the program's Operations Manual. As of November 30, 1991, the CBN had completed its review of all but one of the 17 PBs that had received program funds. According to CBN officials, they found that three banks had ineligible loans made for: a) purchases of buildings already constructed, b) construction that was initiated prior to July 24, 1990, and c) commercial and personal purposes not properly documented.

The CBN disqualified these loans and the three banks were required to reimburse the program. As of November 22, 1991, two banks had reimbursed $5.1 million which was redeposited in an interest bearing reflow account at the National Bank of Panama. According to CBN officials about $2.0 million more will be recovered from the third bank. In addition, a yet undetermined amount may be recovered from a fourth bank.

Of course there is an underlying fallacy in reviewing any of the loans. None of the loans were planned incremental lending just as none were submitted to and reviewed by the BNP prior to the actual lending taking place. Therefore none met the criteria established in the authorization document or possibly even in the agreement. (The Mission, however, contends that they did meet the terms of the agreement.) We do not believe that a review of loans made by a bank before that bank requested A.I.D. funds adds credence to the assumption that the private sector development will benefit. The bank obviously had sufficient medium- to long-term liquidity to make the loans so A.I.D. funds were not needed for those loans. Also, the bank, under the Operations Manual, need not specify what future use will be made of the A.I.D. funds. Therefore, none of the loans that served as a basis for $107.9 million of A.I.D. funds used to purchase ICDs would meet the PAAD requirements since the loans were not planned incremental lending.

The issues identified in this report are not new. In our second semiannual audit report on the Assistance Program (Audit Report No. 1-525-91-014 dated September 12, 1991) we discussed the same issue of program funds provided to banks based on past lending activities rather than planned new lending. In that report, we recommended that USAID/Panama restructure its cash transfer assistance for promoting private sector development to ensure that Act funds were having a direct impact on that intended result.

The Mission decided not to restructure the program because it fundamentally disagreed with us concerning the need to establish a direct linkage between program funds and prospective new lending. According to the Mission everything after July 24, 1990 is by definition "new" lending, and assuming banks met that criteria, it was not concerned about the use of funds by the banks. It considered the program a success because the funds were fully disbursed and were a source of medium-term deposits available to Panama's banking system.

The Commerce Bank obtained $12 million of A.I.D. funds to reactivate the private sector development. However, other than knowing that the bank's liquidity was increased by $12 million, A.I.D. does not know how these funds were used.

We do not believe that substituting the program's funds for bank funds applied to past loans made without regard to the program will necessarily lead to new lending. Any linkage reactivating Panama's economy is even more remote. Hence the need for the Mission to establish a direct link between program's funds and incremental new lending to the private sector.

Considering that the program had been active for more than 16 months at the time of our review and that reflows from the repayments of ICDs are now being disbursed, we do not believe it is appropriate for A.I.D. to continue providing funds to reimburse old lending activity by the banks. If the program is implemented as originally authorized, with plans for new lending and disbursement of funds based on the execution of those plans, a direct link between the program funds and eligible new private sector activities will be established. Thus we are recommending the implementation of the original requirement.

The Private Sector's Need For More Program Funds Should Be Determined

Under the Private Sector Reactivation Program's agreement terms, A.I.D. must provide approval by July 25, 1992, if reflow funds from the repayment of ICDs are to be used to purchase additional ICDs and if so, to what extent. Although the Mission evaluated the program in 1991, the results were inconclusive and the Panamanian private sector's need for the program's funds was not determined. Without this determination reflow funds should not be used to purchase additional ICDs since the Mission would have no assurances that reactivation of the private sector is still needed some two years after the passage of the Act which provided for such emergency measures. Even if a determination is made that the program is still needed, there should be assurance that purchases of ICDs will result in credit activity that would not have otherwise occurred in the absence of the program.

Recommendation No. 2: We recommend that USAID/Panama:

2.1 evaluate the impact of the Private Sector Reactivation Program and determine if A.I.D. funds continue to be needed to reactivate Panama's private sector. This evaluation should include direct contacts with the private sector to determine if its needs for credit are now being generally satisfied and whether continuation of the Private Sector Reactivation Program is the best approach for satisfying any unmet needs identified by the private sector; and

2.2 unless resolved, report the continuation of the program component to purchase ICDs without determining its need as an internal control weakness in the next internal control assessment.

According to the Private Sector Reactivation Program's agreement, the reflow of funds from maturing ICDs would be kept in an interest bearing separate account at the National Bank of Panama (BNP) and, for a period of two years from the date of the signing of the agreement (July 24, 1990), would be used to purchase additional ICDs. But, after two years of program implementation and beginning on July 25, 1992 the reflow funds may be used to: (1) pay non-military bilateral debt owed to the U.S. Government, (2) pay debt owed to international financial institutions such as the World Bank and/or (3) purchase additional ICDs. The GOP with prior A.I.D. approval will be responsible for deciding what proportion of the reflows will be used for each of these eligible uses. The program has now reached a point where substantial ICDs reflows are accumulating. As of November 30, 1991, the reflow account had a balance of $11.8 million.

Recommendation No. 1 of our audit of the Panama Assistance Program for the period through May 31, 1991[11] was that USAID/Panama make an analysis to determine the specific needs of the private sector. We made this recommendation because the Private Sector Reactivation Program was initiated without fully analyzing the need for credit expansion in the Mission's final planning document. Also, Mission officials told us that the local deposits of Panama's general-license banks, which the program was directed at, had recovered to their pre-crisis level.

After we informed Mission management of our observations, in June 1991, USAID/Panama contracted a Panamanian economist to perform an evaluation of the program for the period September 1990 to June 1991. The evaluator's scope of work was "to measure the economic impact of the program by testing the hypothesis that the program funds have been used by individual banks to complement, not to substitute, medium- and long- term loans financed by their own sources of funds". The evaluation was based on questionnaire responses from 11 of the 16 banks participating in the program at that time. There are about 60 Panamanian general-license banks that were eligible to participate. Therefore, information from only 11 of 60 banks was used in the evaluation. Also, because of Panama's bank secrecy laws the evaluator was not able to verify the information collected. While the evaluator concluded that the program should continue, in our opinion the evaluation was inconclusive and the private sector's need for program funds was not determined.

The evaluation report titled the "Banking Sector Performance During 1990 and The Role of the National Economic Recovery Program" was issued in November, 1991. The evaluator concluded that the program was successful because there was an increase in the medium- and long-term portfolio of the banks that used program funds. He found that the beginning loan portfolio for the 11 banks responding to his survey was $621 million and that their ending portfolio was $717 million. Of this $96 million net increase, $56.5 million was attributed to the program's funds with the remaining $39.5 million from bank funds. The conclusion given to these figures was that since the banks used some of their own funds, the program's funds had not been used in place of the banks' own funds.

The above conclusion overlooks the fact that the banks had initially financed the total loan amounts from their own resources, and that, as mentioned in the previous subsection of this report, as the program was implemented, there was no linkage established between bank lending and the program that would allow an assessment of whether the banks would have made the loans anyway in the absence of the program. From the information available we can only conclude that $56.5 million of the program's funds were used by the banks to substitute for bank resources tied up in loans previously made.

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[11] Audit Report No. 1-525-91-014 dated September 12, 1991

To seriously consider the economist's conclusion, the insupportable assumption needs to be made that the program's funds resulted in incremental new lending activities. However, even if such an assumption is made, an analysis of the program results based on overall changes in loan activity at 11 banks overlooks the other loan activity at those banks, not to mention activity of the 49 banks not included in the analysis. Program funds at the institutions surveyed represent a minor amount of their deposit base. Increases in lending activity attributable to the program could be offset by decreases in the banks' other lending activities, or the banks' lending independent of the program could increase. In either case an analysis based on increases or decreases in the banks' overall lending activities would not represent the program's true effect.

To take the immediate case, one would expect that the overall loan increase at the banks surveyed would have been at least double the amount of program funds received because the program provides only half the qualifying loan amount. In fact the overall increase did not reach this level which would mean that apart from the increase from the program there was a decrease in the banks' overall lending activity.

The evaluator recognized that it was not possible to make "robust" conclusions regarding whether the banks used the program's funds to complement their lending activities. In fact he stated that banks may have used the program's funds to reduce their commitment to term lending and he recommended that this point be explored further. However we understand that he recommended keeping track of the banks' overall lending activity as a mechanism to verify that banks are using program funds to complement rather than substitute for their other lending activities. As we have already noted above such an analysis is off the mark. The GOP's National Banking Commission also believed that the mechanism would not show the true effect of the program.

Up to this point we have basically discussed the weakness in the evaluation's assumptions and analysis which leave it short of supporting a conclusion that the program complemented the participating banks' lending activity. Our contention is that the only conclusion that can be drawn is that the program's funds were used by the banks for unknown purposes.

One would imagine that the program's funds stimulated Panama's economy in some small way[12] but that does not mean the program's funds were needed, i.e. that loans would not have been made in the absence of the program.

The Mission for its part considered that: a) the evaluation provided clear information that the program was contributing to the economic recovery of Panama, b) the

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[12] The \$107.9 million of program funds amounts to one percent of the \$10.9 billion deposit base at June 1991 for Panama's national banking system.

recovery was clearly still underway, and c) demand for new investment credit continued. It therefore released the final tranche of $35.9 million.

The Mission also emphasized the role the program was playing in filling a gap existing in Panama's banking system between medium term deposits and medium term loans. The evaluator, however, did not believe that this was a valid reason to continue the program.

Although the Mission had an advance copy of our draft report discussing the lack of linkage between the program's funds and private sector lending activities, it did not assure an effective linkage was established before it released the funds and an effective linkage was never established. The Mission did concur with the need to establish a mechanism to ensure that banks only used program funds to complement rather than substitute their medium-term lending. However, the mechanism developed and implemented by Panama's National Banking Commission was to have banks report their overall loan levels. But as we have noted previously such a mechanism does not provide for linking program funds to new lending activity. And, even if it could be assumed that new lending of the type the program was meant to support was embodied in the overall loan levels reported by the banks, the banks' other lending activities not associated with the program would have to be extracted from the overall figures to give a true picture of the effect of the program. By both measures the linkage mechanism that was established is unsatisfactory.

A direct link between program funds and incremental new lending activities is needed if the program is to continue.

So, as the program approaches the two-year point at which a decision will be made to either continue purchasing ICDs with reflows from the program or to apply such reflows to debt repayment, the need for the program's funds still has not been established. We believe this issue should be revisited and if a need cannot be clearly established, then the program's funds should be applied to debt repayment.

In June 1991 Panama's national banking system had total deposits of $10.9 billion against total loans of $8.0 billion with a ratio of liquid assets to deposits nearly equal to levels before the banking crisis during the Noriega years. Loans within Panama amounted to $4.1 billion, somewhat lower than the $4.4 billion peak mentioned in the evaluation report as having been reached in September 1987. These figures seem to indicate that the resources exist within Panama's national banking system to recover and possibly exceed its former lending levels without the stimulus of an A.I.D. program.

A problem with analyzing the need for A.I.D.'s program and its contribution to Panama's economic recovery is that the program amount of $107.9 million is so small compared to the $10.9 billion deposit base of Panama's national banking system at June 1991 that it would not appear to have the potential to measurably impact the overall progress of Panama's economic recovery. In any case, the lack of a direct linkage between program funds and incremental new lending activities in our opinion prevents any justification of continuing the program as it is currently being implemented.

Mission Comments and Our Evaluation

USAID/Panama disagreed with our conclusions and recommendations on the Private Sector Reactivation Program. We have quoted the Mission's comments which we believe to be the basis of its disagreement and have evaluated each of those comments.

The Mission believes that "The draft report attempts to redefine Agency policy and, more specifically, what was approved by A.I.D./W as the end use of the funds under the Private Sector Reactivation Program....by starting from a false premise, the conclusions reached in the draft report are without foundation and cannot be supported."

In our opinion, the report does not redefine either Agency policy or the A.I.D./W-approved use of funds. In fact, the report clearly shows the purpose of the Program as stated in the Congressional Notification and the Program Assistance Approval Document as approved by A.I.D./Washington. And the report's conclusions are based on those very documents.

The Mission stated that "It would also be necessary to require the tracking of Program funds to individual loans. However, as has been argued consistently by the Mission--and as was explicitly stated in the Program design and authorization--<u>the program does not finance individual transactions</u>."

We agree that the Program does not finance individual transactions, but it is not true that it would be necessary to track Program funds to individual loans to link the Program to new lending. In fact, USAID/Panama established a control technique to establish such a linkage without the detailed monitoring required to track individual loans. This technique was that A.I.D. funds would be used to purchase ICDs only after the implementing agency had reviewed and approved bank plans to expand productive lending. However, USAID/Panama did not implement this control.

The Mission, to show that it was concerned about what the funds were used for, stated that it had "... contracted with a local, reputable economist to evaluate the impact of this Program. The evaluation confirmed that the Program was effective in achieving its intended purpose. It must be recognized, however, that the intended use of the funds is to increase liquidity through the purchase of ICDs; it is not to finance individual projects."

The Mission, as indicated by the above statements does not understand the intended use of the funds. The Act stated that "Private sector development... are needed...." The Congressional Notification stated "To assist the Government of Panama... to increase credit." The authorization document stated "The purpose of the Private Sector Reactivation Program is... to reactivate the banking system to permit an increase in credit...." Therefore, the funds were not to increase liquidity to the banks but rather were to cause an increase in credit to the private sector.

The Program had two purposes. One was to increase liquidity to prevent a "run" on Panamanian banks. The second was to increase credit to the private sector. We believe the Mission confused those purposes and continued with activities to prevent a "run" on the banks even though they acknowledge that this did not occur.

The Mission believed that we had misinterpreted the Program design. It stated: "A second area of dispute on the findings, also related to the Private Sector Reactivation Program, is the notion of participating banks 'officially joining' the program....The draft report indicates that such a requirement existed and that $21.8 million in Program funds were disbursed before the respective bank 'joined' the Program (and, thus, a link cannot be made to 'new lending'). This is clearly a misinterpretation of the Program design...".

The Program design required advance review and approval of planned loans. The simple fact is that USAID/Panama did not implement the program as designed, rather it decided to make loans eligible for Program funds if they were made after July 24, 1990, the date the agreement was signed. This action bypassed the design requirement that ICD purchases be based on the implementing agency's review and approval of bank plans to expand productive lending.

The Mission disagreed that funds were disbursed improperly. It stated that "since no specific act was required to join the Program, the conclusion that $21.8 million were disbursed improperly is without foundation...". The Mission requested the conclusion be dropped from the report.

We have modified this conclusion but retained the discussion which shows examples of old loans that were indisputably made without the lending institutions anticipating the subsequent receipt of A.I.D. funds. Clearly these loans did not support the Program's purpose of causing incremental new lending.

Finally, the Mission commented that our comparison of the size of the Program to total deposits in Panama's banking system distorts the potential impact of the Program on economic recovery. It offered a macroeconomic analysis that estimated

Panama's total private sector investments and suggested a comparison to that amount would be fairer.

We included the comparison of the size of the Program to deposits in Panama's banking system to indicate the impossibility of determining if the Program funds resulted in incremental lending through macroeconomic analysis. Given this purpose, we do not believe it is important whether the comparison is based on $5 billion or $10 billion.

Did A.I.D. establish and maintain financial and administrative systems to ensure that development project activities were implemented in accordance with A.I.D. policies and procedures?

For the development projects that we tested, A.I.D. established and maintained financial and administrative systems to implement its development project activities in accordance with A.I.D. policies and procedures except that, under its participant training program, USAID/Panama did not send the required medical certifications on participant trainees in a timely manner so as to assure their coverage by health and accident insurance, nor ensure the accuracy of accrued expenditure data and contractor billing information. Also in its management of audit requirements the Mission did not: (1) establish systems to monitor audit requirements and track recommendations, (2) use correct standard audit provisions, and (3) establish separate funding for audits in its bilateral projects and agreements with non-U.S. nongovernmental grantees. Further we noted that the Mission's documentation of its internal control system in mission orders was not kept up-to-date.

The Mission fully justified and defined technical services, adequately contracted those services, and properly monitored contractor performance.

For this audit objective we reviewed USAID/Panama's implementation of A.I.D.'s policies and procedures for three development project inputs--technical services, commodities and participant training. We also reviewed implementation of audit requirements.

For the three projects tested, USAID/Panama had followed A.I.D. policy and procedures for technical services. The Mission fully justified and defined the services required, prepared implementing documentation and contracts with sufficient specificity to control contractor performance, and established and implemented monitoring systems to track contractor activities. However, because of our limited sample size and the fact that at the time of our audit implementation of technical assistance was still in its initial stages, we are limiting our conclusions on this positive finding to the items actually tested.

With respect to commodities, for the three projects tested the Mission had properly planned the types, quantities, costs, and sources of the commodities. The Mission had also ensured that commodities ordered were received by the implementing entity. However, it did not clearly establish the responsibilities for monitoring commodity usage, and upon our noting a lack of Mission monitoring of commodity usage for the one project that had actually received the planned for commodities at the time of our review, the Mission requested the implementing entity to provide such information.

With regard to participant training activities, USAID/Panama ensured the quality of those selected for training by following strict criteria and conducting evaluations. A follow-up program for returned participants had also been established. Although the Mission had not completed its country training plan, it had prepared alternate documentation which contained much of the same information and had implemented new projects based on the alternative documentation. The Mission had increased supervisory oversight of the participant training program which could help to alleviate problems that we identified.

Regarding audit requirements, we noted that 14 of 19 agreements contained the current version of standard provisions for audit. Although the Mission had not established a system to monitor audit requirements or track audit recommendations it agreed such a system was needed and stated that it would establish one.

Under the following captions we provide more detail on those areas where compliance with A.I.D. policies was questioned or where improvements were needed:

- USAID/Panama Needs To Better Manage Its Participant Training Program
- Internal Controls Need To Be Better Documented
- Current Version Standard Provisions For Audit Need To Be Used In All Agreements
- Systems To Monitor Audit Requirements And Track Audit Recommendations Need To Be Established
- Specific Budgets For Audit Are Needed For Projects

USAID/Panama Needs To Better Manage
<u>Its Participant Training Program</u>

A.I.D. missions are required to designate an officer to oversee the management and implementation of their participant training programs. This officer is to ensure that every participant training program is conducted in accordance with A.I.D.

Handbook 10, "Participant Training." Additionally, A.I.D.'s Controllers Guidebook and A.I.D. Handbook 19, "Financial Management" require that A.I.D. use the accrual expenditure system of accounting. Also financial records and reports should accurately reflect the status of project activities. USAID/Panama did not fully adhere to this practice or fully comply in all cases with handbook requirements in implementing its participant training program because proper monitorship was lacking. This lack of oversight resulted in inaccurate accounting accruals, unverified financial discrepancies, and inappropriate processing of trainees. Since USAID/Panama has taken appropriate measures to improve the management and implementation of the participant training program we are not making any recommendation.

A.I.D. Handbook 10 states that it is A.I.D. policy that an officer be designated in each A.I.D. mission to oversee management of the participant training portfolio. It is the responsibility of the training officer to see that all participant training programs at the Mission comply with Handbook 10 requirements. Additionally A.I.D. Handbook 19 provides guidance regarding the financial aspects of managing projects. Our review identified one instance of noncompliance with A.I.D. Handbook 10 requirements and two areas where financial management of the program was weak.

The noncompliance issue pertains to participant trainees without required health and accident insurance coverage. A.I.D. Handbook 10 and a more recent cable (State 315156 dated September 23, 1991) on participant training insurance enrollment procedures require the Mission to send a medical certification cable to the contractor programming participant training prior to a participant's departure for training. The contractor prepares and forwards required documentation to A.I.D's Office of International Training (OIT) which in turn notifies the Health and Accident Coverage (HAC) Program to enroll the participant. Until the HAC Program receives this notification participants are not covered by insurance.

On August 24, 1990, USAID/Panama sent a medical certification cable on 43 participants being processed by Georgetown University under the Central American Peace Scholarship (CAPS) project. However, 34 of the 43 participants had departed Panama and arrived in the U.S. prior to the sending of the cable starting that insurance enrollment process. Moreover, two days after the cable was sent, the other 9 participants arrived in the United States. There was insufficient time to process the enrollment of these participants in the insurance program. Thus all 43 participants traveled to the U.S. under the auspices of USAID/Panama without having proper insurance coverage and thus subjecting A.I.D. to undue liability.

The Mission's lack of oversight resulted in the above situation. However, in September 1991 a new project officer was assigned to oversee the participant training program and has since instituted appropriate control procedures.

With regard to financial management, the two areas needing Mission attention are inaccurate accruals and unverified financial data.

Inaccurate Accruals

A.I.D.'s Controller's Guidebook and Handbook 19, "Financial Management," require that A.I.D. use the accrual expenditure system of accounting. A.I.D.'s Controller's Guidebook states that:

> A.I.D. utilizes the accrued expenditure system of accounting for projects in order to provide management with the monetary value of material provided and services actually performed applicable to each project on a current basis...Accrued expenditures represent costs incurred during a given period for goods received and services rendered. Expenditures accrue regardless of whether cash payments are made, or invoices have been rendered...In developing accruals, USAID's are to analyze the disbursement vouchers and advices of charge and the unliquidated obligation files in conjunction with the reports from contractors, procurement agent status reports, data provided by other USAID officials and previous Mission experience.

A.I.D.'s Handbook 19 further states:

> Officials responsible for project assistance have been assigned specific responsibility for planning and controlling accrued expenditures applicable to their projects.

At September 30, 1991, USAID/Panama had underestimated accruals for the Central American Peace Scholarship (CAPS) Project by at least $879,000. In developing accruals for the CAPS Project, USAID/Panama did not use readily available information such as disbursement vouchers and reports from contractors. For the period ending September 30, 1991, the Mission estimated accruals at $3,000,000; however, it had in its files data covering expenditures of $3,570,498 as of June 30,1991. Taking this June figure and adding the Mission's estimated accruals of $308,475 for July 1 through September 30, 1991, the total estimate for the project should have been $3,878,972 not $3,000,000.

Accruals are important because actual expenditures are often not recorded to the Mission's accounting records for as much as a year after the actual expenditures are made. This has occurred because the Advice of Charge system used by A.I.D. to account for payments made by one office on behalf of another office has been known to experience lengthy voucher processing delays.

Thus, without the actual expenditure data management must rely on accrual information to determine the financial status of a project at any point in time. The

Mission acknowledged the need for accurate accruals and assigned to a project officer the responsibility to ensure that all available data be used in the calculation of accrual expenditures.

Unverified Financial Data

Financial records and reports should accurately reflect the status of project activities. In the management of the Central American Peace Scholarship Project, the Mission did not question or verify differences in figures that occurred between contractor reports and liquidation vouchers for the same time period. For example, for the quarter, April 1 to June 30, 1990, the contractor quarterly report showed $520,000 in expenditures when liquidation vouchers for the same period were $712,000. As of December 31, 1990, the reverse was found; the contractor reported total expenditures of about $15,700,000 when actual liquidation vouchers were about $15,300,000. These differences had not been checked or verified by the Mission's participant training office; however, subsequent to our review procedures were established to ensure the verification of financial data.

Internal Controls Need To Be Better Documented

A.I.D. offices are responsible for ensuring that internal control systems consisting of organizational structures, operating procedures, and administrative practices are established and maintained to provide reasonable assurance that program and administrative activities are effectively carried out. USAID/Panama had not maintained an up-to-date mission order system which is the administrative mechanism for the dissemination of Mission policy, regulations, procedures, and information governing the conduct and administration of the programs and responsibilities assigned to USAID/Panama. This happened because USAID/Panama officials did not take the time to update the mission orders because they were preoccupied reestablishing the Mission after its being closed for two years and implementing of the Assistance Program. As a result, USAID/Panama after approximately two years of operation does not have a set of mission orders that it can rely on to assure that the Assistance Program is being implemented as effectively and efficiently as possible.

Recommendation No. 3: We recommend that USAID/Panama review its mission order system and revise, add, or delete, as appropriate, those mission orders needed to establish and document in an up-to-date status its internal control system.

System documentation includes policies and procedures, organizational charts, manuals, memoranda and other written material to describe organization structure, operating procedures and administrative practices necessary to communicate responsibilities and authorities for accomplishing programs and activities. Management needs such documentation to effectively control their operations.

USAID/Panama's mission order system was established as the official medium for issuing, revising and disseminating policies, rules, regulations, and procedures and other continuing guidance or instructional material for conducting USAID operations. Divisions with responsibility for specific procedures and operations of Mission activities were required to maintain up-to-date copies of all appropriate mission orders. When outdated, the entire mission order was to be reissued.

At the time of our review the mission order system being maintained by USAID/Panama was outdated and not generally used by Mission personnel. Of the approximately 67 existing mission orders, 12 had been issued in 1977 or earlier. Although the Mission had issued five new orders in 1990 and one in 1991, a complete review and updating of the system had not taken place even though the Mission reopened in early 1990, approximately two years ago.

The issue of mission orders was initially brought to our attention during our review of technical services and the contracting of those services. The Mission's internal control procedures for procuring technical services would normally be documented in its mission order system. The mission order for "Contracting of Goods and Technical Services" was dated November 22, 1977. The Mission contracting officer had never seen this order and stated that because of numerous changes to procurement and contracting regulations it was too out-of-date to be of any use.

During our review of project commodities we found that the responsibilities for monitoring commodity usage had not been clearly established. This resulted in the lack of oversight of such usage for the only project that had received commodities at the time of our review. Handbook 15, Chapter 10 states that project officers have the ultimate responsibility for ensuring that project commodities financed by A.I.D. are being effectively utilized in the project and project objectives are being met. Although the Mission ensured the delivery of commodities to the implementing entity, the project officer had not monitored commodity usage because she thought such monitoring was the responsibility of another Mission office. We believe that since commodities are often times an integral part of many A.I.D. programs the responsibility for monitoring commodities should be clarified and documented in USAID/Panama's mission order system.

Mission management stated that the mission order system had not been reviewed and updated because of higher priority concerns associated with starting up the Assistance Program. However, since the Mission has been operating for about two years since its reopening, we believe that the Mission should place a higher priority on documenting internal controls to ensure the efficient and effective implementation of program activities. Without these controls management has less than reasonable assurance that obligations and costs are proper, assets and funds are safeguarded against waste, loss, unauthorized use, and misappropriation, revenues and expenditures are properly accounted for, and programs are carried out in accordance with applicable law and management policy.

Current Version Standard Provisions For
Audit Need To Be Used In All Agreements

Current Handbook 13 standard provisions for audit require that non-U.S. nongovernmental grantees have audits performed which meet U.S. Government Auditing Standards while U.S. nongovernmental grantees must have audits performed in accordance with Office of Management and Budget (OMB) Circular A-133. USAID/Panama was not using current version standard audit provisions in 5 of its 6 Handbook 13 agreements. As a result, audits could be performed without meeting required standards.

> **Recommendation No. 4: We recommend that USAID/Panama obtain the current standard provisions for audit and amend the agreements accordingly.**

A.I.D. Handbook 13 mandatory standard provisions for non-U.S. nongovernmental grantees entitled "Accounting, Audit, and Records", May 1991 revision, requires that:

> The audit shall be a financial audit performed... in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States.

In addition, A.I.D. Handbook 13 standard provisions for U.S. nongovernmental grantees, revised September 1990, incorporates by reference the requirements of OMB Circular A-133, "Audits of Institutions of Higher-Education and other Nonprofit Institutions".

As of October 1991, USAID/Panama had not received either of these standard provisions from A.I.D./Washington. On May 2, 1991, A.I.D./Washington sent a bulletin to all USAID contracting officers reemphasizing the need to use revised audit provisions for U.S. nongovernmental grantees. Although this bulletin was not in USAID/Panama files it had been requested by the contracting officer but had not been received. Our office notified the Mission in a memo dated June 28, 1991, of the changes required for audits of non-U.S. nongovernmental organizations but the Mission did not use this information to amend agreements.

Our review of the 6 USAID/Panama Handbook 13 agreements showed that 5 did not include the proper audit provisions. It should be noted however, that in November 1991 we presented an audit training course to Panamanian audit firms conducting audits on USAID/Panama's program. Audit standards were distributed to all attendees and we were told by USAID/Panama's assistant controller that all audits would be performed according to these standards. Notwithstanding the Mission's intentions in this area, USAID/Panama should incorporate the current standard provisions for audit in its project agreements.

Systems To Monitor Audit Requirements And Track
Audit Recommendations Need To Be Established

The Mission had not established audit follow-up systems required by Handbook 19, because initial audit activity had been limited and priorities had been placed on other Mission activities. The Mission should not further delay the establishment of audit follow-up systems because its overall program is now entering the stage where increasing numbers of audits will be performed. The audits and recommendations need to be tracked.

Recommendation No. 5: **We recommend that USAID/Panama:**

5.1 establish systems to monitor audit requirements and track audit recommendations; and

5.2 report this weakness, unless resolved, in its next assessment of internal controls.

Office of Management and Budget Circular A-50 requires agencies to establish audit follow-up systems to assure the prompt resolution and implementation of audit recommendations. In addition, A.I.D. Handbook 19, Attachment 16A, provides policy and procedures for audit follow-up and resolution. Standard audit provisions in all A.I.D. agreements require that periodic audits be conducted on the programs being implemented.

In this regard, the Mission has developed a universe of recipients of its funds and taken initial steps to ensure that required audits will be performed. The Mission should now formalize a system to ensure that the required audits will not only be conducted but also that the recommendations will be implemented.

These systems had not been formally developed by the Mission because initial audit activity had been limited and priorities had been placed on other Mission operations. The Mission agreed that these systems were necessary and stated that it would take action to see that they were established and maintained.

Specific Budgets For Audit Are Needed For Projects

A.I.D. Handbook 3, which applies to bilateral project assistance and certain types of grants to nongovernmental organizations, requires that the need for audits be evaluated and, when audits are needed, that the funds be specifically budgeted for audit and not intermingled with other project requirements. Handbook 13, which applies to grants to nongovernmental organizations, does not require a specific budget item for audits but does require audits. For bilateral project assistance grants, the Mission frequently combined audit with other budget line items. Also, some grants to non-U.S. nongovernmental organizations did not budget funds for audits which will need to be performed under the new recipient contracted audit program. Without a specific budgeted amount funds may not be available for required audits.

Recommendation No. 6: We recommend that USAID/Panama establish separate budget line items for audit in those project agreements where the Mission intends to fund the grantee's costs of complying with A.I.D.'s audit requirements.

A.I.D. Handbook 3, "Project Assistance," requires that final planning documents (Project Papers) include an evaluation of the need for audit in light of potential risks, and a statement describing the audit coverage that is planned. It further requires that project funds be specifically budgeted for audit and not intermingled with other project requirements unless adequate audit coverage is reasonably assured or audits are not warranted.

A.I.D. Handbook 13, "Grants," states that prudent management normally requires audit. Also the standard provisions for Handbook 13 grants require audits. Handbook 13 does not provide guidance regarding the need to budget funds for audits. However, the incremental costs of such audits would be chargeable to A.I.D.'s agreements either as a direct or indirect cost. Therefore, in order to ensure that funds are available for Handbook 13 projects, we believe that the cost of such audits should be explicitly addressed in the agreement budget similar to the requirement under Handbook 3 guidance.

Our review found that for 9 of the 12 agreements, three Handbook 13 agreements lacked a budget for audit, and the budgets for audit for five Handbook 3 and one Handbook 13 agreements were combined with other project activities, usually evaluations.

The Mission had not consistently included separate budget line items for audits in its project agreements because Mission personnel were not aware of A.I.D.'s requirement as stated in Handbook 3 and because there was no specific guidance to budget funds for audit in Handbook 13. As a result, funding for required audit activities have not been clearly established resulting in a lack of assurance that needed funds will be available.

The Mission should include separate budget line items for audit both for bilateral project assistance and grants to non-U.S. nongovernmental organizations.

Mission Comments and Our Evaluation

The Mission agreed with the findings on Mission orders, audit provisions, and audit monitoring/tracking systems and stated that it is taking the steps necessary to close the recommendations.

Recommendations 3, 4 and 5 are resolved upon issuance of this report.

The Mission disagreed with the recommendation to establish separate budget line items for audit because it interprets the word "should" in the Handbook 3 language to be guidance and not a requirement.

We believe USAID/Panama's interpretation is a narrow one that does not take into consideration the entire Handbook reference. For example, the reference states that every project design document will assess the implementation and financing of each project activity. Moreover, it states that an evaluation of the need for audit coverage is required and project funds should be specifically budgeted for audit and not intermingled with other project requirements unless adequate audit coverage is otherwise reasonably assured or not warranted. Therefore, we believe the Handbook is quite specific in that once it is determined that an audit is needed then project funds should be specifically and separately budgeted for audit.

REPORT ON INTERNAL CONTROLS

This section is a summary of our assessment of internal controls for the audit objectives.

Scope Of Our Internal Control Assessment

We performed our audit in accordance with generally accepted government auditing standards, which require that we (1) assess the applicable internal controls when necessary to satisfy the audit objectives and (2) report on the controls assessed, the scope of our work, and any significant weaknesses found during the audit. We limited our assessment of internal controls to those controls applicable to the audit's objectives and not to provide assurance on the auditee's overall internal control structure.

We classified significant internal controls applicable to each audit objective by categories. For each category, we identified the relevant controls and determined whether they have been placed in operation--and we assessed control risk. We have reported these categories as well as any significant weaknesses under the applicable section heading for each audit objective.

General Background On Internal Controls

Under the Federal Managers' Financial Integrity Act of 1982 and the Office of Management and Budget's implementing policies, A.I.D.'s management is responsible for establishing and maintaining adequate internal controls. The General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining internal controls.

The objectives of internal controls and procedures for Federal foreign assistance are to provide management with reasonable--but not absolute--assurance that resource use is consistent with laws, regulations, policies and agreement terms; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether a system will work in the future is risky because (1) changes in conditions may require additional procedures or (2) the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusions for the Audit Objectives

Conclusion for Audit Objective One

Our first objective was to determine if A.I.D. implemented the cash transfer assistance under the Economic Recovery Program in accordance with program authorization documents and agreement terms. To answer this objective we reviewed the agreement process and the monitoring process. Our review showed that USAID/Panama was following A.I.D.'s internal controls in these areas for this program. We found that authorization requirements had been incorporated into the agreement and the Mission was appropriately implementing and monitoring program activities.

Conclusion for Audit Objective Two

Our second objective was to determine if A.I.D. implemented the cash transfer assistance under the Private Sector Reactivation Program in accordance with program authorization documents and agreement terms. To answer this objective we reviewed the agreement process and the monitoring process. Our review showed that USAID/Panama was following A.I.D.'s internal controls in these areas except that the authorization document requirement for participating banks to submit plans for future lending activities and for program disbursements to be made when such lending occurred had not been incorporated by the Mission into the agreement. Further, the review found that a Mission-funded evaluation of the need for the program was inconclusive so the need for the program still has not been established.

The Mission's 1990 assessment of its internal control structure, done to comply with A.I.D. Payment Verification Policy No. 1 and the Federal Managers' Financial Integrity Act, did not identify the above problems as failures to follow applicable internal controls.

Conclusion for Audit Objective Three

Our third objective was to determine if A.I.D. established and maintained financial and administrative systems to ensure that development project activities were implemented in accordance with A.I.D. policies and procedures. For this objective we concentrated our review on certain project inputs: technical services, commodities, and participant training. Additionally, we reviewed audit requirements. The control processes assessed were:

- planning,
- project implementation orders,
- contracting,
- monitoring,
- auditing, and
- internal control documentation.

Our review showed that for the projects tested, the Mission had followed the Agency's internal control policies and procedures for technical services and for commodities. The Mission was following the Agency's internal controls for participant training except that it had not sent medical certifications timely to the U.S. so that participants would be covered by health and accident insurance upon their arrival in the U.S., nor ensured the accuracy of accrued expenditure data and contractor billing information. Regarding audits, the Mission had followed A.I.D. policy and procedures in this area except that it (1) had not established a system to monitor audit requirements and track audit recommendations, (2) certain agreements did not contain the most recent standard provisions for audit, and (3) most non-U.S. nongovernmental and bilateral agreements did not contain a separate budget line item for audit. Lastly, the Mission's documentation of its internal control systems in mission orders was not kept up-to-date. We consider the Mission not ensuring the accuracy of financial information under its participant training program and its lack of a system to monitor audit requirements and recommendations to be material weaknesses.

The Mission's 1990 assessment of its internal control structure, done to comply with A.I.D. Payment Verification Policy No. 1 and the Federal Managers' Financial Integrity Act, did not identify the above problems.

REPORT ON COMPLIANCE

This section summarizes our conclusions on USAID/Panama's compliance with applicable laws, regulations, binding policies, and agreement terms.

Scope Of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards, which require that we plan and perform the audit to fairly, objectively, and reliably answer the audit objectives. Those standards require that we:

- assess compliance with applicable requirements of laws, regulations, binding policies and agreement terms when necessary to satisfy the audit objectives (which includes designing the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives) and

- report all significant instances of noncompliance and abuse, and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

We tested the Mission's compliance with the Federal Managers' Financial Integrity Act of 1982, Office of Management and Budget (OMB) Circular Nos. A-50, A-123, and A-133, and assistance agreement provisions as they could affect our audit objectives. However, our objective was not to provide an opinion on the Mission's overall compliance with such provisions.

General Background On Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grants, binding policies and procedures, and agreements governing an organization's conduct. Noncompliance constitutes an illegal act when there is a failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance and criminal acts. Not following internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition of noncompliance and is included in our report on internal controls. Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the letter of the laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with the Federal Managers' Financial Integrity Act of 1982; OMB Circulares A-50 and A-123; and agreement provisions is the overall responsibility of the Mission's management.

Conclusions On Compliance

For the assistance activities tested, USAID/Panama complied with the above mentioned laws, binding policies, and agreement terms except that it did not establish audit follow-up systems as required by OMB Circular A-50.

SCOPE AND METHODOLOGY

Scope

We audited the Panama Assistance Program funded with the $420 million provided by Public Law 101-302 in accordance with generally accepted government auditing standards. At November 30, 1991, this Assistance Program consisted of two cash transfer programs and nineteen development projects. We conducted our audit from September 16, 1991 through December 13, 1991.

The audit covered the Assistance Program's two cash transfer programs with respect to whether those programs had been implemented in accordance with program authorization documents and agreement terms, and it covered development projects with respect to whether the project inputs of technical services, commodities and participant training were planned, contracted for, and monitored in accordance with A.I.D.'s policies and procedures. The audit also reviewed implementation of audit requirements for project activities.

The audit period was May 25, 1990 through November 30, 1991. At November 30, 1991 Assistance Program obligations were $420 million and accrued expenditures $159.8 million. Fieldwork was conducted in the offices of USAID/Panama, USAID/Costa Rica (the official accounting station for USAID/Panama), the National Bank of Panama, Panama's National Banking Commission and two accounting firms conducting external audits.

The audit objectives did not cover the following areas:

- We excluded four development projects from the scope of our review. Three of these, project Nos. 525-0305, 525-0310 and 525-0311, were budget transfers to other U.S. Government entities. A.I.D. Handbook 12 on use of Federal agencies does not provide guidance for such situations so it was not clear whether A.I.D. expected that these projects follow A.I.D. Handbook guidance. However, we did request the Department of Justice (DOJ) Inspector General to audit project No. 525-0305 to determine whether the DOJ's implementation, monitoring and accounting for the project is in accordance with the DOJ's policies and procedures. The fourth project (525-0300) was designed prior to the passage of the Act and implementation activities were completed shortly after the Act-funded Assistance Program began. Act funds merely reimbursed the original sponsor. We therefore considered this project to be outside the scope of our review.

- We did not audit controls over project development and operating expenses because we believe that the Congressional intent is that we audit the direct assistance provided to Panama.

- We did not audit the computerized segment of the Mission Accounting and Control System (MACS). Thus we were only able to observe its workings in terms of original input documents and report outputs.

- We did not review supporting documentation for loans supporting interbank certificates of deposit under the second cash transfer program, the Private Sector Reactivation Program, because under Panamanian banking law the only entity with authority to review the documentation of Panama's private banks is the Government of Panama's National Banking Commission.

USAID/Panama management confirmed in writing that:

- It was responsible for establishing procedures to: (1) implement an internal control system, (2) ensure compliance with applicable laws and regulations, and (3) ensure the fairness and accurracy of the accounting and management information it processed, and

- It provided, to the best of its knowledge, full access to all financial and management information available in the Mission associated with the Panama Assistance Program, and this information does not reveal any material instances of irregularities or noncompliance with applicable laws, regulations, or legally binding requirements.

Methodology

The methodology for each audit objective follows.

Audit Objective One

To accomplish the first audit objective, we obtained and reviewed the Program Assistance Approval Document for the Economic Recovery Program, the program agreement, and related program documentation, to include Government of Panama implementation plans, Panama's Letter of Policy submitted to the international financial institutions, signed World Bank and InterAmerican Development Bank (IDB) Minutes of Negotiations, and the International Monetary Fund's Fund Monitoring Program for Panama. In addition, we interviewed officials of the Mission, Government of Panama, International Monetary Fund, World Bank, IDB, U.S. Treasury, and an accounting firm. As of November 30, 1991 we determined the status of the Government of Panama's efforts to reach agreement with the international financial institutions including remaining issues. Additionally, we analyzed the dates and amounts of program disbursements by A.I.D. to a separate account in the Federal Reserve Bank of New York versus the dates and amounts of withdrawals from the separate account for use by the Government of Panama.

Audit Objective Two

To accomplish the second audit objective, we obtained and reviewed the Program Assistance Approval Document for the Private Sector Reactivation Program, the program agreement, USAID/Panama implementation documentation, National Banking Commission and National Bank of Panama documentation, an evaluation report on the program and workpapers for a draft financial audit report. We interviewed officials of the Mission, Government of Panama, National Banking Commission, National Bank of Panama, and an accounting firm. Additionally, we analyzed the dates and amounts of program disbursements by A.I.D. to a separate account in the Federal Reserve Bank of New York versus the dates and amounts of withdrawals from the separate account for use by the private Panamanian banks.

To determine the amount of loans not eligible for the support under the program, we relied on documentation obtained by the above mentioned accounting firm from the National Bank of Panama covering the period since inception of the program to September 30, 1991. We additionally reviewed loan information submitted by participating banks for the month of October 1991.

Audit Objective Three

To accomplish the third audit objective, we determined for a judgmentally selected sample of projects whether the planning, contracting, and monitoring pertaining to technical services, commodities, and participant training was done in accordance with guidance found in A.I.D.Handbooks 3, 10, 13, 15, and 19; OMB Circular A-123 and the Federal Managers' Financial Integrity Act of 1982. We also reviewed all projects to determine compliance with audit requirements specified in A.I.D. Handbooks 3 and 13, and OMB Circulares A-50 and A-133.
We reviewed project documentation including the Country Development Strategy Statement, project papers, agreements, contracts, project implementation orders, progress reports, and financial reports. Our work included interviews with officials of USAID/Panama, United States Embassy Panama and USAID/Costa Rica. We also visited USAID/Costa Rica (the official accounting station for USAID/Panama) to verify project accounting data.

Not all projects selected had progressed sufficiently for us to review all intended areas; for example, only one project had actually received and distributed project commodities.

MANAGEMENT COMMENTS AND OUR EVALUATION

AGENCY FOR INTERNATIONAL DEVELOPMENT

PANAMA CITY, PANAMA

UNITED STATES GOVERNMENT
MEMORANDUM

DATE: March 23, 1992

TO: Reginald Howard, RIG/A/T

FROM: Thomas W. Stukel, DIR TW Stukel

SUBJECT: Mission Comments on Audit of the Panama Assistance Program Funded By Public Law 101-302 as of November 30, 1991

As with the two previous audits of the Panama Assistance Program, USAID/Panama welcomes the opportunity to comment on the draft report of the subject audit. We carefully reviewed this report and note that some of our comments provided to you during your March 17-19 visit to Panama were incorporated. We believe that the open and frank discussions held during your visit were equally valuable to the Mission and RIG staff -- even if, as anticipated, there remain certain areas where we have fundamental disagreements regarding some of the findings presented in the report. If these disagreements cannot be reconciled, there is serious question as to our ability to close Recommendations 1.1 and 1.2.

The principal area of disagreement, which was also a major point of disagreement in the audit report on the Assistance Program as of May 31, 1991, relates to the definition of "final end use" of cash transfer dollars. The draft report attempts to redefine Agency policy and, more specifically, what was approved by AID/W as the end use of the funds under the Private Sector Reactivation Program. Based on your redefinition of the Program, you then identify weaknesses in design and instances of non-compliance in the implementation of the Program. However, by starting from a false premise, the conclusions reached in the draft report are without foundation and cannot be supported. Also, see Appendix III in which RIG's position with respect to tracking cash transfer dollars is used to argue that design weaknesses persist with both cash transfer programs in the USAID/Panama portfolio. The Mission continues to disagree with the RIG position and requests that the Appendix be modified to reflect what was approved by the authorizing officials within policy guidelines, not RIG's "position".

Throughout the discussion on this Program (pp. 24-44), the draft report refers to new lending and the need to link such lending with Program funds. Emphasis is also given to the notion of "past" versus "prospective" lending. This is most clearly seen on p. 25 where the draft report states: "First we [RIG] consider that, as authorized by the LAC Bureau, the program's primary purpose was to support incremental new lending...." However, as the draft report itself acknowledges on p. 28, the approved purpose (as stated in both the PAAD and the Program Agreement) is "to permit an increase in credit to the private sector in Panama." Thus, it is not simply the Mission's "conception" (p. 25) that the primary purpose of the Program is to provide increased credit to the private sector; rather, it is the clearly stated and approved purpose of the Program.

In order to support the conclusion of the draft report that the Program must demonstrate a linkage to new/prospective lending to show that implementation is in accordance with authorization documents and agreement terms, it would first be necessary to accept the Program purpose as redefined in the draft audit report as opposed to what was actually approved by the appropriate AID/W officials. It would also be necessary to require the tracking of Program funds to individual loans. However, as has been argued consistently by the Mission -- and as was explicitly stated in the Program design and authorization -- the Program does not finance individual transactions. Its purpose is to increase credit to the private sector which is accomplished through the purchase of interbank certificates of deposits (ICDs). With the liquidity that is provided through the ICDs, the participating banks have a larger pool of medium term resources available to finance the investment activities of their clients. Thus, the underlying premise of the case made in the draft report is inaccurate. It necessarily follows that the conclusions reached are also inaccurate.

Related to this issue is the statement in the report regarding the Mission's "lack of concern about what the funds were actually used for...[and] to assure its programs are having their intended effect and to assure the funds are not being applied to activities prohibited under U.S. law." (p. 36). We take strong exception to this statement as it implies the Mission is not complying with its most basic responsibility. In fact, the Mission has worked hard to assure that the funds are used as intended. For that reason, procedures were put in place (with the National Banking Commission) to control the use of funds. In addition, we contracted with a local, reputable economist to evaluate the impact of this Program. The evaluation confirmed that the Program was effective in achieving its intended purpose. It must be recognized, however, that the intended use of the funds is to increase liquidity through the purchase of ICDs; it is not to finance individual projects.

This statement was deleted from the final report.

Through its own initiative, the National Banking Commission has identified over $7.0 million in transactions for which Program funds should not have been used, and has recovered those funds from the respective banks. We believe this represents very clear evidence that the Program design and objectives are indeed taken seriously, both by the Mission and the GOP. Therefore, the Mission requests that this discussion in the draft report be deleted since it can only be supported if it is accepted that Program funds can be tracked to individual projects (which they cannot be) and, in any case, it does not reflect the efforts of the Mission and the National Banking Commission to implement the Program in accordance with the approved design.

A second area of dispute on the findings, also related to the Private Sector Reactivation Program, is the notion of participating banks "officially joining" the Program (pp. 32-34). The draft report indicates that such a requirement existed and that $21.8 million in Program funds were disbursed before the respective bank "joined" the Program (and, thus, a link cannot be made to "new lending"). This is clearly a misinterpretation of the Program design and eligibility criteria. The Program did not require a specific action to join. By definition, all general license banks in Panama were eligible to participate. However, before any transaction between the Program and a participating bank occurred, legal documentation was required. This same documentation is required each time a bank requests Program funds, irrespective of whether that bank previously received resources from the Program. Since no specific act was required to join the Program, the conclusion that $21.8 million were disbursed improperly is without foundation and the Mission requests that it be dropped from the report.

The final section of the discussion on the Private Sector Reactivation Program (pp. 42-44) does not provide a clear picture of the banking system in Panama and, therefore, its relation to the potential impact of the Program on economic recovery is distorted. Panama is an international banking center. Thus, total deposits are not the correct base for comparing the size and potential impact of this Program. First, in order to understand what is actually available for local lending, it is necessary to differentiate between foreign and domestic deposits (the former are generally not available for local lending purposes). It is also necessary to distinguish between short term and medium term deposits when looking at domestic funds since the Program addresses the shortage in medium term lending which, properly managed, should be related to medium term domestic deposits. Neither of these most fundamental banking distinctions are reflected in the draft report.

As discussed with the Mission's economist during your visit, a fairer basis for comparison in terms of the size/significance of the Program is an analysis of investment in Panama related to GDP. Over the past couple of years, Panama's GDP has been approximately $5.0 billion with a private sector investment rate of about 12%. This gives an annual investment of some $600 million. When compared to this level of investment, the $107.9 million of the Program is not "small" but is quite significant. Rather than being so small that "it would not have the potential to measurably impact the overall progress of Panama's economic recovery" (p. 44), we believe the opposite is true -- funding from the Program has considerable potential to contribute positively to the recovery process.

While citing figures on total private sector investment is not an exact comparison, we believe it provides the interested reader with a sounder basis for making a judgment about the potential contribution of the Program to economic recovery in Panama. The Mission suggests that, in fact, the discussion on the referenced pages does not add to the report and should be dropped. If the discussion remains in the report, it should be modified to reflect the characteristics of the banking system in Panama and use the above example of investment levels instead.

In terms of the findings in the report on Mission orders, audit provisions and audit monitoring/tracking systems, the Mission has no problems and is already taking the steps necessary to close the recommendations.

On the final recommendation regarding separate budget line items for audit, the Mission notes that the Handbook 3 section cited in the report [3C3e(2)] states that "project funds <u>should</u> be specifically budgeted for audit...." The Mission interprets the use of the word "should" to mean that this is guidance and not a requirement as stated in the report (p. 60). As noted during several conversations with the RIG staff, the Mission agrees that the audit function is an important part of project management. Toward that end, funds are budgeted for audit although, in most cases, those funds are in a line item combined with evaluation. In the limited instances where no funds are budgeted (e.g., Tax Administration Improvement), it is the Mission's judgment that audit by a third party is not warranted. Such a decision is fully consistent with Handbook 3 guidance.

Thus, while the Mission agrees with the general issue of providing for audit coverage (which we have done and which we will continue to do), we disagree with the recommendation in the report because it would require the Mission to take action on a matter that is only subject to Agency guidance (i.e., subject to Mission discretion) and not a requirement or Agency policy. Further,the Mission is not convinced that reprogramming project budgets is needed to assure that funds will be available for this purpose given that, where appropriate, funds have been identified for audit in the project budgets. We therefore request that the discussion and recommendation on this subject be deleted in the final report.

As in the past, we understand that our comments will be attached in their entirety to the final audit report.

PREVIOUSLY REPORTED ISSUES

The following are Assistance Program issues that were unresolved at May 31, 1991 with their resolution status as of November 30, 1991.

Issue Reported	Resolution Status
Under the first cash transfer, the Economic Recovery Program, A.I.D. funds amounting to $113.85 million were to be transferred from a separate account established at the Federal Reserve Bank of New York to a commingled account in Panama to support Panama's public sector investment budget and accordingly cannot be traced to their final expenditure. While the agreement specifies both permissible and prohibited uses of the funds, this arrangement does not permit A.I.D. to monitor their use.	This issue is unresolved as the Mission disagreed and continues to disagree that tracking the funds to their final expnditure is needed. The Mission, with LAC Bureau approval, decided to track the funds for the subprogram to support the Government of Panama's public sector investment budget only to the extent where it could be shown they would be applied to this macroeconomic purpose. Such a macroeconomic purpose for cash transfer assistance is not specifically covered by A.I.D. policy and therefore, no specific guidance existed requiring that the funds be tracked to their final use.
The Private Sector Reactivation Program was not being implemented in accordance with the agreement. Instead of program funds being provided to banks for incremental new lending, the funds were provided to the banks based on their past lending activity.	The Mission disagreed with our interpretation that the agreement required participating banks to submit a plan of their incremental new lending activities and that the program's funds were to be disbursed when the planned lending took place. During this audit we cover the same issue, this time starting from the base that both the program's authorization documents and the agreement (as we interpret it) required such a provision.
The Private Sector Reactivation Program was initiated without fully analyzing the need for credit expansion in the Mission's final planning document.	The Mission conducted an evaluation of the program in response to our discussions with it on this matter. However, in our opinion the evaluation results were inconclusive and the Panamanian private sector's need for the program's funds was not determined.
Evaluations, called for by the agreements for each cash transfer program to be conducted shortly after the end of 1990, had been deferred.	As of November 30, 1991 the evaluation of the $243.85 Economic Recovery Program still had not been done. An evaluation of the $107.9 million Private Sector Reactivation Program was conducted after

we discussed our concerns about that program. However in our opinion the results of that evaluation were inconclusive.

Under the Improving Police Services Project, funds for project implementation were transferred from A.I.D. to the Department of State and from State to the Department of Justice (DOJ). The funds were transferred without going through the analytical and review processes that A.I.D. would normally call for on a project of this magnitude.

According to Mission officials, A.I.D. provided the funding but does not have any responsibility for the project. A.I.D. handbooks do not address situations such as this where a transfer of funds is made under a memorandum of understanding (MOU). Therefore it was not clear whether A.I.D. intends that its handbook guidance on design and approval of projects should apply in such situations. We excluded this and two other projects involving transfers of funds under MOUs from the scope of our review this reporting period. However we did request the DOJ Inspector General to determine whether this project has been implemented, monitored and accounted for in accordance with DOJ's policies and procedures.

Under the Private Sector Scholarships Project, the implementing entity, COSPAE, had not proven its ability to contract and account for training activities to be conducted through U.S. organizations, and therefore the potential existed that it might not be able to adequately control and account for the funds.

This potential problem has been resolved. COSPAE has made substantial progress in strengthening its administrative capacity to carry out the project's activities and has contracted with two U.S. organizations to manage short and long term training activities.

A mission order formally establishing the Mission's monitoring and evaluation system had not been issued.

The Mission told us in August 1991 that it had a person on long-term temporary duty for this purpose, yet the Mission has not issued a mission order formally establishing a monitoring and evaluation system as required by the Evaluation Handbook.

A.I.D. Handbook 3 guidance specifies five elements to be included in project design to permit evaluation. In our last audit we noted that two bilateral projects and one operational program grant did not include logical frameworks as required by Handbook 3 guidance.

We did not make a recommendation in this area and the Mission has taken no action to comply with this Handbook requirement.

APPENDIX IV

Financial Status of the Panama Assistance Program
As of November 30, 1991 1/ 2/
Funded Under the Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act
(Unaudited)

Program/ Project Number	Title	Implementing Organizations (Primary-Sub)	Budgeted Amount (000s)	Obligated Amount (000s)	Accrued Expenditures (000s) 2/	Disbursed Amount (000s)
	CASH TRANSFERS:					
525-0303	ECONOMIC RECOVERY PROGRAM					
	Repayment of GOP Debt Arrearages	MIPPE and BNP	$130,000	$130,000	0	0
	Support to GOP Public Investment Budget	MIPPE and BNP	113,850	113,850	$29,850	$29,850
525-0304	PRIVATE SECTOR REACTIVATION PROGRAM	CENA and BNP	107,900	107,900	107,900 3/	107,900
	SUBTOTAL CASH TRANSFERS		$351,750	$351,750	$137,750	$137,750
	DEVELOPMENT PROJECTS:					
525-0258	PRIVATE SECTOR SCHOLARSHIPS	COSPAE	500	500	0	0
525-0281	PANAJURU LOCAL SCHOLARSHIPS	PANAJURU	500	500	0	0
525-0287	LOW COST SHELTER-HG-013	GOP/AID	300	300	10	10
525-0300	EMERG. REHAB. OF CHORRILLO APARTMENTS	MIVI	2,500	2,500	2,449	2,449
525-0302	IMMEDIATE RECOVERY PROJECT AMENDMENT					
	Replacement Housing	MIVI and Caja de Ahorro	5,355	5,355	4,591	3,657
	Food and Shelter to Displaced Persons	Camara de Comercio	1,900	1,900	1,769	1,769
525-0305	IMPROVING POLICE SERVICES	Dept. of State - Dept. of Justice	13,200	13,200 4/	6,400	6,400 4/
525-0306	FINANCIAL MANAGEMENT REFORM	CG, MIPPE, and MHT	4,500	4,500	0	0
525-0307	DEMOCRATIC INITIATIVES:					
525-0307.01	Journalism Strengthening	Florida Intl. Univ.	500	500	75	63
525-0307.02	Civic Education	Am. Develop. Fnd. - Civic Crusade	240	240	46	26
525-0307.03	Aid to Electoral Tribunal	IIDH/CAPEL	840	840	597	596
525-0307.04	Legislative Development	Consortium for Leg. Dev.	700	700	0	0
525-0307.05	Commodities	Government of Panama	30	30	27	27
525-0308	NATURAL RESOURCE MANAGEMENT	INRENARE & NATURA	10,000	10,000	0	0
525-0310	PEACE CORPS - NATURAL RESOURCES	Peace Corps	100	100 4/	99	99 4/
525-0311	USIA-TRAINING	USIA	500	500 4/	395	224 4/
525-0312	IMPROVED ADMINISTRATION OF JUSTICE	Sup. Court, Public Minist Bar Assoc. & Univ. of Pan	6,900	6,900	88	88
525-0313	ECONOMIC POLICY DEVELOPMENT	MIPPE	3,100	3,100	7	7
525-0314	TAX ADMINISTRATION IMPROVEMENT	IRS	1,600	1,600	175	175
525-0319	AIFLD	AIFLD	138	138	38	0
525-0320	WHITE CROSS/NARCOTICS AWARENESS	Panamanian White Cross	250	250	0	0
525-1000	CENTRAL AMERICAN PEACE SCHOLARSHIP					
	Participant Training Program	Georgetown University	5,450	5,450	1,000	0
525-1001	CLASP	Not yet selected	4,360	4360	0	0
598-0790	AIFLD LABOR DEVELOPMENT PROGRAM	AIFLD	500	500	500	500
	SUBTOTAL DEVELOPMENT PROJECTS		$63,963	$63,963	$18,266	$16,090

Financial Status of the Panama Assistance Program
As of November 30, 1991 1/ 2/
Funded Under the Fiscal Year 1990 Dire Emergency Supplemental Appropriations Act
(Unaudited)

Program/ Project Number	Title	Implementing Organizations (Primary-Sub)	Budgeted Amount (000s)	Obligated Amount (000s)	Accrued Expenditures (000s) 2/	Disbursed Amount (000s)
525-0000	PROJECT DEVELOPMENT AND SUPPORT	A.I.D.	1,006	1,006	589	536
	OPERATING EXPENSES	A.I.D.	3,281	3,281	3,159	3,159
	SUBTOTAL MISSION EXPENSES		$4,287	$4,287	$3,748	$3,695
	TOTAL FY 1990 DIRE SUPPLEMENTAL		$420,000	$420,000	$159,764	$157,535

1/ This report includes financial information obtained from USAID/Panama relating to several program activities managed through A.I.D./Washington. USAID/Panama does not maintain the official accounting records for these activities so this information may not be complete and accurate--particularly with regard to those projects being implemented through other U.S. Government entities.

2/ Accrued expenditure information in this table is based on USAID/Panama's estimations which have not been verified. Therefore this table may not reflect the exact expenditures under the Assistance Program.

3/ Interbank Certificates of Deposit purchased by BNP from private Panamanian banks as of November 30, 1991.

4/ Budget transfers to other U.S. Government entities. Amounts are based on reports provided by the implementing entities. The Actual status may be different.

PANAMA ASSISTANCE PROGRAM
STATUS OF IMPLEMENTATION OF DEVELOPMENT PROJECTS
AS OF NOVEMBER 30, 1991 [1]

PRIVATE SECTOR SCHOLARSHIPS PROJECT NO. 525-0258

Amount Budgeted:	$500,000
Amount Obligated:	$500,000
Amount Disbursed:	0

The purpose of the project is to establish a private Panamanian organization (COSPAE) with broad private sector participation which can identify training needs, select trainees, arrange training programs, and successfully reincorporate training participants into the Panamanian economy.

As of November 30, 1991 no Public Law 101-302 funds had been disbursed; however, project activities continued using funds previously authorized. These activities included: (1) implementation of a comprehensive computerized financial management system, (2) a number of fund-raising activities, and (3) the development of tailor-made programs to select students to pursue associate degrees in the United States.

COSPAE is still in the process of preparing its five-year plan which is behind schedule.

PANAJURU LOCAL SCHOLARSHIPS PROJECT NO. 525-0281

Amount Budgeted:	$500,000
Amount Obligated:	$500,000
Amount Disbursed:	0

The purpose of the project is to provide classroom and on-farm training for economically disadvantaged Panamanian rural youth to improve skills and technologies. This project was suspended for a period of 14 months due to the economic and political crisis of 1988-90. It was reactivated in April, 1990. The project provides scholarships to train rural youth to work in the agricultural sector as farm managers, supervisors, agricultural extension agents, and other positions.

As of November 30, 1991 the project had not required the use of Public Law 101-302 funding as

[1] Unaudited information based on evidence contained in USAID/Panama records.

it continued operations using previously authorized funding. Enrollment decreases had been reversed. Recent enrollment increases have been at a 15 percent annual rate. Moreover, 60 percent of graduates receiving scholarships had returned to local communities to work in the agricultural sector. Thirty rural schools were participating in the project.

PRIVATE SECTOR LOW COST SHELTER PROJECT NO. 525-0287	Amount Budgeted:	$300,000
	Amount Obligated:	$300,000
	Amount Disbursed:	$ 10,000

The purpose of the project is to support the Mission's housing program through technical assistance which will increase the involvement of the private sector in long term mortgage lending for low cost shelter.

This project was undertaken primarily to allow the Mission to carry out two Housing Guaranty projects initiated before USAID/Panama's closure in 1987.

As of November 30, 1991, a long term advisor had been contracted. Other technical and legal advisors were to be subsequently contracted in response to project needs.

REHABILITATION OF CHORRILLO APARTMENTS PROJECT NO. 525-0300	Amount Budgeted:	$2,500,000
	Amount Obligated:	$2,500,000
	Amount Disbursed:	$2,449,000

This project reimbursed the A.I.D. Office of Foreign Disaster Assistance (OFDA) for costs associated with the rehabilitation of the "24 de Diciembre" apartment complex and other apartment buildings that suffered damage during the U.S. military operation in Panama. The work was completed in July 1990.

IMMEDIATE RECOVERY PROJECT NO. 525-0302 Housing and Food and Shelter components	Amount Budgeted:	$7,255,000
	Amount Obligated:	$7,255,000
	Amount Disbursed:	$5,426,000

The original Immediate Recovery Project budgeted at $25.125 million and later amended to $32.380 million (with $7.255 million in Act funds) was to assist the Government of Panama to provide replacement housing to displaced families from the Chorrillo area of Panama City, carry out employment generation activities, and restore public sector institutions. Act funds were to be used for (1) replacement housing and (2) food and shelter for displaced persons, $5.355 million and $1.9 million respectively.

As of November 30, 1991, both project components had been completed with over 2100 homes delivered and the emergency shelter and feeding activities discontinued. We issued non-Federal audit reports on these components on November 15, 1991 (Audit Report Nos. 1-525-92-06-N and 1-525-92-07-N).

IMPROVING POLICE SERVICES
PROJECT NO. 525-0305

Amount Budgeted:	$13,200,000
Amount Obligated:	$13,200,000
Amount Disbursed:	$ 6,400,000

This program is designed to improve police services in Panama. Assistance is directed towards establishing basic police skills training, developing a model precinct, developing professional training cadres and a police academy, and establishing offices of professional responsibility within the National Police and the Technical Judicial Police.

The $13.2 million budgeted for this project was transferred through a memorandum of understanding to the Department of Justice (DOJ). The project is being implemented by the U.S. Department of Justice's International Criminal Investigative Training Assistance Program (ICITAP), which has an office in Panama. It is being monitored by the U.S. State Department through the American Embassy Panama.

We requested the DOJ Inspector General to review ICITAP's activities under the project with regard to compliance with DOJ's systems for implementation, monitoring and accounting. The DOJ IG's audit had not been issued by our audit cut-off date.

FINANCIAL MANAGEMENT
REFORM
PROJECT NO. 525-0306

Amount Budgeted:	$4,500,000
Amount Obligated:	$4,500,000
Amount Disbursed:	0

The purpose of the project is to improve and integrate the Government of Panama's financial management and audit systems and to promote accountability of government officials in managing public resources. The project will provide technical assistance, on-the-job training, and limited commodities.

Due to delays in meeting the condition precedent to create a technical task force for the National Economic Council, the project has not progressed as quickly as originally planned. However, the Government of Panama has created a new office of the Auditor General within the Controller General's Office.

Planned life-of-project funding is $6.3 million with $4.5 million from Act funds.

DEMOCRATIC INITIATIVES
PROJECT NO. 525-0307

Amount Budgeted:	$2,310,000
Amount Obligated:	$2,310,000
Amount Disbursed:	$ 712,000

This is an umbrella project with five sub-projects designed to assist Panamanian efforts to reestablish and consolidate a representative democratic government with full public participation, including a free press.

As of November 30, 1991 some of the project's accomplishments by subproject were:

1) Journalism Strengthening Subproject

A series of seminars and workshops have been given to Panamanian print and broadcast media professionals.

2) Civic Education Subproject

The subgrantee, the Civic Crusade Foundation's Center for Democracy has conducted youth leadership seminars, democracy fairs at universities, workshops to bolster democratic participation of interest groups in public policy formulation, etc.

3) Electoral Tribunal Subproject

Technical assistance and training was provided to electoral officials and observers in preparation for the January 1991 elections. The same is being done for the 1992 constitutional referendum.

4) Legislative Development Subproject

A six-month work plan and financial plan was received from the grantee, the Consortium for Legislative Development. Interviews for a local coordinator were taking place.

5) Commodities Subproject

USAID/Panama procured $30,000 in office equipment for the Electoral Tribunal.

NATURAL RESOURCES MANAGEMENT
PROJECT NO. 525-0308

Amount Budgeted:	$10,000,000
Amount Obligated:	$10,000,000
Amount Disbursed:	0

The purpose of the project is to protect and manage Panama's renewable natural resources, with particular emphasis on the Panama Canal's watershed area. The project's three major components are: (1) management of the Panama Canal watershed, (2) management of national parks and wildlands, and (3) support for the establishment of a nature foundation.

The Government of Panama has submitted documents to comply with the conditions precedent to initial disbursements in order to contract for long term technical assistance and architectural drawings. But the project hinges upon a debt-for-nature swap so that a long term source of funding can be established. Should the debt-for- nature swap not occur, the project will have to be modified and/or redesigned.

Planned life-of-project funding is $18 million with $10 million planned from Act funds.

PEACE CORPS
PROJECT NO. 525-0310

Amount Budgeted:	$100,000
Amount Obligated:	$100,000
Amount Disbursed:	$ 99,000

The project supported Peace Corps' volunteers assisting Panama's National Institute for Renewable Natural Resources (INRENARE) in Panama Canal watershed management. Peace Corps' activities included agriculture extension, environmental education, small business development, and related activities. The Act funds supported the Peace Corps initial re-entry into Panama and longer term support was to be provided through INRENARE under the Natural Resources Management Project.

U.S. INFORMATION AGENCY TRAINING
PROJECT NO. 525-0311

Amount Budgeted:	$500,000
Amount Obligated:	$500,000
Amount Disbursed:	$224,000

The purpose of the project is to assist Panamanian efforts to reestablish and consolidate representative democratic government with full public participation.

The $500,000 has been transferred to the United States Information Agency to among other activities send Panamanian legislators to the United States to observe legislative operations. Other activities include conducting legislative seminars and training for Panamanian judges and prosecutors to expose them to the U.S. system of justice.

IMPROVED ADMINISTRATION OF JUSTICE
PROJECT NO. 525-0312

Amount Budgeted:	$6,900,000
Amount Obligated:	$6,900,000
Amount Disbursed:	$ 88,000

The purpose of the project is to improve the operation and coordination of the justice system (i.e., Judiciary, Public Ministry and Public Defenders) in the conduct of the investigative and trial stages of the criminal justice process.

As of November 30, 1991, four new courts had been established, Justice sector officials had participated in international and regional activities, and two seminars were provided under the current technical services contract.

The Justice sector has recently experienced budgetary cuts leaving inadequate resources to meet institutional needs. This has become a policy dialogue agenda item for the USAID/Panama Mission Director and the Ambassador.

Planned life-of-project funding is $12 million with $6.9 million planned from Act funds.

ECONOMIC POLICY DEVELOPMENT PROJECT NO. 525-0313	Amount Budgeted:	$3,100,000
	Amount Obligated:	$3,100,000
	Amount Disbursed:	$ 7,000

The purpose of the project is to assist the Government of Panama in expanding and strengthening the process of economic policy making. The project is to provide technical assistance to Panama's Ministry of Planning and Economic Policy to develop and implement economic policies. As of November 30, 1991 a technical assistance contract had been signed with Development Technologies, Inc. for an estimated $2.3 million. A senior management advisor, hired under the contract has been participating in the recent negotiations between the Government of Panama and the international financial institutions.

Planned life-of-project funding is $5 million with $3.1 million planned from Act funds.

TAX ADMINISTRATION IMPROVEMENT PROJECT NO. 525-0314	Amount Budgeted:	$1,600,000
	Amount Obligated:	$1,600,000
	Amount Disbursed:	$ 175,000

The purpose of the project is to improve the Government of Panama's ability to organize and operate its tax collection system.

It is to provide technical assistance, training, and commodities to assist the Government of Panama's Office of Tax Administration Advisory Service.

A Participating Agency Services Agreement had been signed with the Internal Revenue Service to implement the project. Three long term advisors were working in country as of the audit cut-off date.

AIFLD/PANAMA PROJECT NO. 525-0319	Amount Budgeted:	$138,000
	Amount Obligated:	$138,000
	Amount Disbursed:	0

The purpose of this project is to support the program of the Panama office of the American Institute of Free Labor Development (AIFLD/Panama) aimed at strengthening the capabilities of democratic labor in Panama in the following areas: 1) collective bargaining; 2) organizing; 3) administrative and financial management; and 4) union participation.

As of November 30, 1991 several regional and national seminars had been held under the areas listed above. As of the same date the Mission reported accrued expenditures of $38,000.

DRUG AWARENESS AND PREVENTION
PROJECT NO. 525-0320

Amount Budgeted:	$250,000
Amount Obligated:	$250,000
Amount Disbursed:	0

The purpose of the project is to upgrade the technical capability of the staff of Cruz Blanca (White Cross), a local private voluntary organization. It is also to provide training for approximately 1440 volunteers in modern techniques of drug awareness and prevention enabling them to actively participate in programs designed to increase public awareness of the adverse effects of illegal drug usage and ways of prevention.

The project grant agreement was signed on September 28, 1991. As of November 30, 1991 the project had not started but Cruz Blanca was planning to contract technical assistance to initiate training of its staff.

CENTRAL AMERICAN PEACE SCHOLARSHIP
PROJECT NO. 525-1000

Amount Budgeted:	$5,450,000
Amount Obligated:	$5,450,000
Amount Disbursed:	0

The purpose of the project is to equip a broad base of leaders and potential leaders in Panama with technical skills through training and academic education, and in the process help them to better understand the working of a free enterprise economy in a democratic society.

Georgetown University manages all project activities except for English language training, which is done by the Panama Canal College.

Act funds are being used for the training and support costs for 43 Panamanians sent to the United States in August 1990 for long term university degree training and for 17 Panamanian high school English language teachers sent for short term training. As of November 30, 1991 the Mission estimated accrued expenditures of about $1 million.

CARIBBEAN AND LATIN AMERICAN SCHOLARSHIP PROGRAM II (CLASP II) PROJECT NO. 525-1001	Amount Budgeted: Amount Obligated: Amount Disbursed:	$4,360,000 $4,360,000 0

The purpose of the project is to equip a broad base of leaders and potential leaders in Panama with technical skills, training and academic education, and an appreciation and understanding of the working of a free enterprise economy in a democratic society.

As of November 30, 1991 the implementing agency for the project had not been selected; however, the Mission was preparing the Requests for Proposals (RFPs). The Mission was in the process of selecting the first group of long-term scholars.

AIFLD LABOR DEVELOPMENT, LAC BUREAU REGIONAL PROJECT NO. 598-0790	Amount Budgeted: Amount Obligated: Amount Disbursed:	$500,000 $500,000 $500,000

The purpose of this regional project is to assist free and democratic labor organizations and unions in Latin American countries to develop effective trade union leadership. Activities were to include trade union organizing, collective bargaining, labor management relations and financial management. The Mission transferred $500,000 to A.I.D.'s LAC Bureau as a contribution toward funding the regional cooperative agreement with the American Institute for Free Labor Development. All the funds have been disbursed.

APPENDIX VI

REPORT DISTRIBUTION

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