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Regional Inspector General for Audit
San José, Costa Rica

Audit of USAID/El Salvador's Management of Cash Advances to Recipient Organizations

Audit Report No. 1-519-95-003
December 21, 1994

INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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December 21 , 1994

MEMORANDUM

TO: USAID/El Salvador Director, Henry W. Reynolds

FROM: RIG/A/San José, Coinage N. Gothard, Jr. Coinage N. Gothard, Jr.

SUBJECT: Audit of USAID/El Salvador's Management of Cash Advances to Recipient Organizations

The Office of the Regional Inspector General for Audit/San José has completed its audit of USAID/El Salvador's management of cash advances to recipient organizations. This final audit report is being transmitted to you for you action.

In preparing this report we reviewed your comments on the draft report and included them as Appendix II. A summation of your comments has been included after each of the problem areas addressed in the report.

Based upon your written comments, we consider all recommendations resolved upon issuance of this report. Please respond to the report within 30 days indicating any actions taken to implement the recommendations.

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

Regional Inspector General for Audit
San José, Costa Rica

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December 21, 1994

Central America

EXECUTIVE SUMMARY

Federal policy endorses advancing cash in reasonable amounts to certain types of organizations such as nonprofit and educational organizations. However, the same policy requires that Federal funds be limited to the minimum amounts necessary for immediate disbursement needs. As of April 20, 1994, the USAID/El Salvador financial management system showed outstanding cash advances totaling $61.3 million.

USAID policy also favors that local currency generated under Economic Support Fund (ESF) cash transfer programs be placed in interest-bearing accounts and be programmed for purposes mutually agreed upon by USAID and the host country, so long as such accounts are permitted under host-country law and regulation and do not undermine internationally-supported stabilization agreements and sound monetary policy. There is no specific guidance that local currency can be used to make cash advances in lieu of using appropriated dollars.

USAID/El Salvador generally did limit advances to immediate disbursement needs of recipients. However, USAID/El Salvador could improve its cash management practices in the following areas:

- USAID/El Salvador did not ensure that cash advances to recipients were deposited in interest-bearing accounts. If advances were placed in interest-bearing accounts, an additional $2.3 million in interest income could be earned in the future under current agreements with recipients of cash advances. (See page 6.)

- USAID/El Salvador did not have a system to ensure that interest earned by recipients had been remitted to the U.S. Treasury. As a result, $24,072 in interest for two recipients had not yet been remitted. (See page 6.)

- USAID/El Salvador did not place local currency generated under its ESF cash transfer programs in interest-bearing accounts. If the local currency was placed in interest-bearing accounts, interest earned between May 1994 and April 1996 could total $3.3 million—money that could be used to carry out the developmental purposes for which new funds provided by USAID would be used. (See page 11.)

- USAID/El Salvador could probably use local currency to provide cash advances to government recipients and subrecipients in lieu of appropriated dollars. We estimate such financing could have saved the U.S. Treasury about $1.8 million between May 1994 and April 1996. (See page 11.)

The report includes five recommended actions aimed at improving USAID/El Salvador's cash management practices.

In responding to the draft audit report, USAID/El Salvador's management generally concurred with the findings and recommendations except for the methodology used to compute the $2.3 million in potential interest that could be earned if cash advances were placed in interest bearing accounts. However, we believe the methodology used was sound. The Mission also determined that there would not be enough local currency to provide cash advances in lieu of appropriated dollars. USAID/El Salvador's comments are discussed after each finding and are included in their entirety as Appendix II.

Office of the Inspector General

Office of the Inspector General
December 21, 1994

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INTRODUCTION

Background

The U.S. Treasury requires Federal agencies to conduct their financial activities in a cost-effective manner so that the maximum amount of cash is made available to the Treasury on a continuing basis for purposes of investing and avoiding unnecessary borrowing. Inefficient cash management costs the taxpayer millions of dollars each year and contributes to the increase in the Federal debt. As a result, the Administration and the Congress have urged Federal agencies to improve their management of cash advances to program recipients.

Federal policy endorses advancing cash in reasonable amounts to certain types of organizations such as nonprofit and educational organizations. The U.S. Agency for International Development (USAID) extends this policy to all nonprofit organizations, including U.S. or international private voluntary organizations and international research institutions. USAID policy also recognizes that host government institutions will normally be financed on an advance-of-funds basis. These policies ensure that the organizations will not have to use their own working capital to finance work done under USAID agreements.

The U.S. Treasury (1 TFM 6-2025 and 2075.30) requires Federal agencies to monitor recipients' cash management practices to ensure that advances of Federal funds are limited to the minimum amounts necessary for immediate disbursement needs and to take remedial action when the advances are excessive to those needs. USAID policy expects that judgement will be applied by USAID controllers, grant officers and others in determining the immediate disbursing needs of recipients. The advance should be based on an analysis of working capital in which the timing and amount of cash advanced will be as close as administratively feasible to limit the advance to the minimum amount needed for immediate disbursing needs (i.e. up to 30 days from date received until expended). The advance period may be extended up to 90 days when the appropriate USAID approving officer (e.g. Mission Director) has made a written determination that implementation will be seriously interrupted or impeded by applying the 30-day maximum.

As of April 20, 1994, USAID/El Salvador financial management system showed outstanding cash advances totaling $61.3 million.

Audit Objectives

The Regional Inspector General for Audit in San José audited USAID/El Salvador's management of cash advances to recipient organizations to answer the following questions:

- Does USAID/El Salvador limit cash advances to the immediate cash needs of recipients in accordance with USAID policy and U.S. Treasury regulations?

- Does USAID/El Salvador ensure that recipients maintain cash advances in interest-bearing accounts and remit the interest earned to U.S. Treasury in accordance with Federal requirements and USAID policy.

- Does USAID/El Salvador program the local currency generated through its programs to provide cash advances to project recipients in lieu of using appropriated dollars to buy local currency?

Appendix I discusses the scope and methodology for this audit.

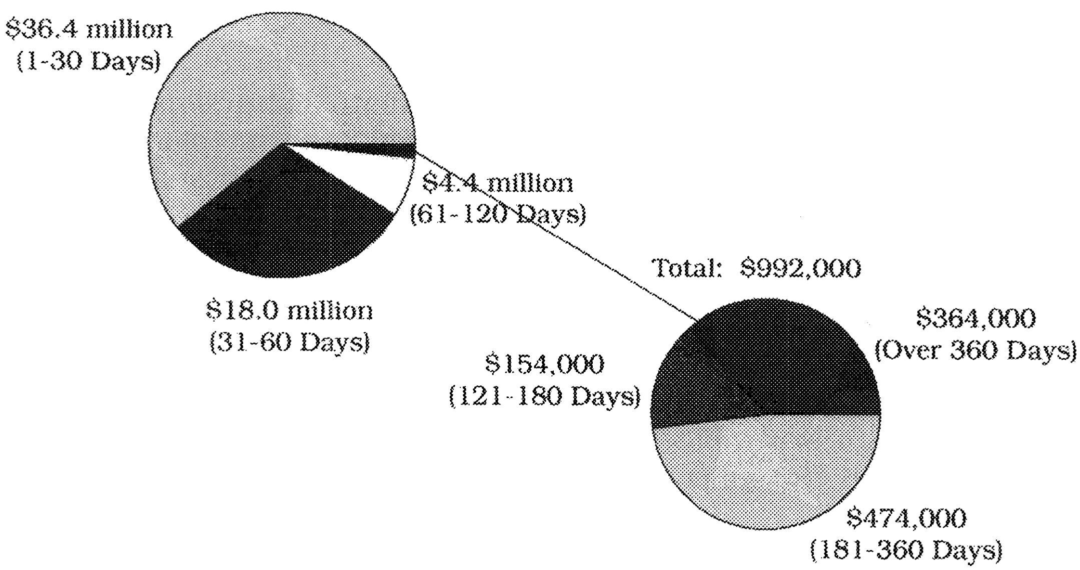
REPORT OF AUDIT FINDINGS

Does USAID/El Salvador limit cash advances to the immediate cash needs of recipients in accordance with USAID policy and U.S. Treasury regulations?

USAID/El Salvador generally did limit cash advances to immediate cash needs of recipients in accordance with USAID policy and U.S. Treasury regulations.

USAID/El Salvador has devoted extensive efforts to controlling and monitoring cash advances given to recipients. USAID/El Salvador maintains a cash advance aging schedule to track outstanding advances that have not been liquidated in its financial management system. As of March 31, 1994, USAID/El Salvador's schedule showed the following:

Aging Report for USAID/El Salvador Cash Advances as of 3/31/94
(Unaudited)



BEST AVAILABLE

U.S. Treasury policy requires Federal agencies to limit cash advances to recipient organizations to the minimum amounts necessary for immediate disbursement needs. For example, U.S. Treasury policy (1 TFM 6-2025) states:

> Advances to a recipient organization will be limited to the minimum amounts necessary for immediate disbursement needs and will be timed to be in accordance only with the actual immediate cash requirements of the recipient organization in carrying out the purpose of an approved program or project.

USAID Handbook 19 (Appendix 1B) states that recipients paid by check receive advances to cover needs for up to 30 days unless a designated official (Bureau Assistant Administrator, USAID Director, or Office head) extends the period of the advance for up to 90 days with a written justification that implementation will be seriously interrupted or impeded by applying the 30-day rule. Handbook 19 states that federal cash is not to be maintained in excess of immediate disbursing needs and that excess funds should be promptly returned to the U.S. Treasury.[1]

USAID/El Salvador generally did limit advances to immediate cash disbursement needs (i.e. 30 days). We reviewed six vouchers for each of the five largest recipients of cash advances. Our review showed the following:

- One recipient had cash in excess of immediate disbursement needs for one month out of six months reviewed. The recipient had an excess of $182,904 which would have covered an additional 31 days of cash disbursement needs.

- Two recipients had cash in excess of immediate disbursement needs for two months out of six months reviewed. One recipient had an excess of $95,192 which would have covered an additional 17 days and $51,126 which would have covered an additional 8 days. The second recipient had an excess of $115,053 which would have covered an additional 6 days and $57,600 which would have covered an additional 3 days.

- One recipient had cash in excess of immediate disbursement needs for three months out of six months reviewed. The recipient had an excess of $125,186 which would have covered an additional 11 days,

[1] This policy further states that the only exception to this requirement for prompt refunding are when funds "will be disbursed by recipients within seven calendar days or are less than $10,000 and will be disbursed within 30 calendar days."

$329,832 which would have covered an additional 30 days, and $59,740 which would have covered an additional 11 days.

The fifth recipient was a government of El Salvador organization (SETEFE[2]) which is responsible for the disbursement of advances to approximately 50 subrecipients. Although SETEFE and USAID/El Salvador records show substantial outstanding advances, such is not the case. For example, USAID/El Salvador's records and SETEFE's voucher showed that SETEFE had cash on hand of $19.4 million and $20.1 million, respectively as of September 30, 1993. However, these amounts are not indicative of what SETEFE and its subrecipients actually had on hand to cover disbursements needs.

For example, a comparison of the outstanding $19.4 million in cash advances according to USAID/El Salvador records against the balances in SETEFE's and its subrecipients' bank records (as of September 30, 1993) showed a significant difference. A couple of examples are noted below:

- USAID/El Salvador's records showed that one subrecipient had $1.0 million as an advance outstanding. However, the recipient's bank statements showed that most of this advance had been disbursed and only $76,709 was on hand.

- USAID/El Salvador's records showed that another subrecipient had $900,000 as an advance outstanding. However, the recipient's bank records showed that most of this advance had been disbursed and only $203,408 was on hand.

The reason for the appearance of excessive advances based on USAID/El Salvador's records and SETEFE's vouchers requesting additional advances is attributable to funds that have been disbursed by the recipients or subrecipients but the documents showing the actual disbursements (liquidations) had not yet been processed. Based on our calculation it takes an average of 93 days (ranging from 14 days to 320 days) for SETEFE to liquidate an advance with USAID/El Salvador.

In conclusion, based on our detailed analysis of six vouchers of five recipients and a cursory review of other vouchers for the same recipients and another recipient, we do not believe there is a material and systemic problem in USAID/El Salvador limiting cash advances to immediate disbursement needs.

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[2] SETEFE is the acronym for the Technical Secretariat for External Financing (Secretaría Técnica para el Financiamiento Externo).

Does USAID/El Salvador ensure that recipients maintain cash advances in interest-bearing accounts and remit the interest earned to the U.S. Treasury in accordance with Federal requirements and USAID policy?

USAID/El Salvador did not ensure that recipients maintain cash advances in interest-bearing accounts and remit the interest earned to the U.S. Treasury in accordance with Federal requirements and USAID policy.

Cash Advances Should Be Placed in Interest-bearing Accounts

Federal requirements and USAID policies require that recipients deposit cash advances from USAID in interest-bearing accounts and remit interest earned to the U.S. Treasury. USAID/El Salvador did not ensure that these requirements were met because it believed that: (1) deposits of advances to the Government of El Salvador into interest-bearing accounts would adversely affect the Government of El Salvador's fiscal policy and (2) other recipients and subrecipients did not have the capability to properly account for any interest earned on the advances. Also, USAID/El Salvador did not have a system to monitor interest earned on deposits that had been deposited in interest-bearing accounts. If advances were to be placed in interest bearing accounts, interest of $2.3 million could be earned in the future under current agreements with recipients. Moreover, $24,072 of interest was earned by recipients that had not been remitted to the U.S. Treasury.

Recommendation No. 1: We recommend that USAID/El Salvador:

1.1 instruct recipients of cash advances to deposit such advances in interest-bearing accounts and ensure that the instructions are followed;

1.2 develop a system to ensure that interest earned on cash advances is remitted to the U.S. Treasury; and

1.3 ensure that the $24,072 of interest earned by recipients identified in this report as not been remitted to the U.S. Treasury is remitted.

U.S. Treasury policy (1 TFM 6-2075.30a) requires that recipients and subrecipients of cash advances from Federal agencies deposit the advances in interest-bearing accounts and that the interest earned be remitted to the

U.S. Treasury at least quarterly.[3] USAID Handbooks 13 (Chapter 1) and 19 (Appendix 1B) prescribe the same requirements for U.S. nonprofit organizations but do not explicitly require other recipients (e.g., foreign governmental and non-U.S. organizations) to deposit the advances in interest-bearing accounts and for the remittance of the interest earned on such deposits. For example, USAID Handbook 19 simply states that USAID should monitor recipients' cash management practices "...to ensure that...except where contrary to law, interest earned on federal funds by recipient organizations is promptly paid over to the Treasury."

USAID/El Salvador did not require recipients to deposit advances in interest-bearing accounts. Bank statements for the 24 recipients and subrecipients we reviewed showed that 22 did not maintain their cash advances in interest-bearing accounts.

These problems occurred because: (1) USAID/El Salvador officials believed that such deposits on advances provided to the Government of El Salvador would adversely affect the country's monetary policy and (2) most other recipients including subrecipients of the Government of El Salvador did not have the capability to properly account for the advances.[4] In fact, the Government of El Salvador's organization (SETEFE), which is responsible for the disbursement of advances to approximately 50 active subrecipient activities, requested USAID/El Salvador in March 1993 for permission to deposit the advances in interest-bearing accounts. USAID/El Salvador denied the request in April 1993 because USAID/El Salvador was concerned about SETEFE's and its subrecipients' ability to handle the complexity of managing and accounting for the interest generated.

As a result of not requiring the recipients to deposit cash advances in interest-bearing accounts (as illustrated on the next page and in Appendix III), interest income which would have been earned to date and could be earned in the future under current agreements with recipients totaling $1.2 million and $2.3 million, respectively.

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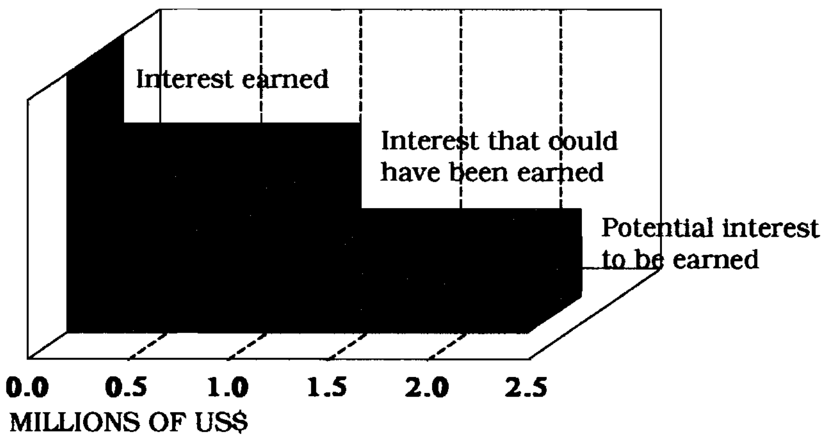
[3] USAID Handbook 13 (Chapter 1) provides that interest amounts up to $100 per year may be retained by the recipient and subrecipient for administrative expenses and interest earned will be remitted at least quarterly to USAID.

[4] USAID/El Salvador officials told the auditors at the exit conference in May 1994 that the above cited reasons for not allowing the recipients to deposit the advances in interest-bearing accounts may no longer be valid reasons. The officials said that they would look into the feasibility of requiring cash advances be deposited in interest-bearing accounts.

Analysis of Potential Interest Earned on Cash Advances (10/1/92 thru 8/97)



Our review of bank statements from October 1992 to April 1994 for 24 recipients and subrecipients showed that only two had placed funds in interest-bearing accounts and neither of these had remitted all the interest to the U.S. Treasury as required. One of the two recipients had not remitted interest earned from January 1992 through April 1994 totaling $20,214 to the U.S. Treasury. The second recipient did remit interest totaling $5,445 that was earned during the period January 1993 to December 1993, but had not yet remitted $3,858 as of May 1994 of interest earned from January 1994 to April 1994.

USAID/El Salvador officials said they did not have a system to monitor nor to ensure that interest earned on deposits placed in interest-bearing accounts was remitted to the U.S. Treasury. For example, USAID/El Salvador was not aware that the first recipient mentioned above had earned interest on its deposits.

In conclusion, USAID/El Salvador should: (1) instruct recipients of cash advances to deposit such advances in interest-bearing accounts and ensure that the instructions are followed, (2) develop a system to ensure that interest earned on cash advances are remitted to the U.S. Treasury, and (3) ensure the $24,072 of interest earned by recipients identified in this report as not having been remitted to the U.S. Treasury is remitted.

Management Comments and Our Evaluation

USAID/El Salvador generally concurred with the findings and recommended actions. For example, in response to Recommendation No. 1.1, the Mission established a policy to require all non-U.S. recipients whose advance balances reported in the Mission Accounting and Control System (MACS) consistently exceed $250,000 to deposit the advances in interest-bearing accounts. The Mission stated that this policy would cover: (1) all recipients whose actual bank balances for advances are $85,000 or more and for some whose average bank balances are even less and (2) an estimated 99 percent (i.e., $43 million) of all advances to local recipients. The Mission stated that the same criterion will be applied to subrecipients. The Mission judges that this is a reasonable and effective alternative to requiring all non-U.S. recipients to deposit advances in interest-bearing accounts. The Mission noted that USAID policy does not currently require that non-U.S. recipients keep advances in interest-bearing accounts.

However, the Mission did not specifically address the need to ensure that U.S. recipients deposit advances in interest-bearing accounts. The Mission also thought that the auditors' computation for the $2.3 million in potential interest to be earned was highly speculative. The Mission's conclusion is based on the fact that the methodology used in the computation assumed that: (1) all activities under one project (519-0394) have the same remaining life as the project itself, whereas some of the activities have already terminated and others terminate before the project ends and (2) overall advance balances will be the same in the future as they were in the past.

Regarding the Mission's first position, although the auditors did use the remaining life of Project Number 519-0394, most ($1.5 million) of the projected potential interest ($2.1 million) that could be earned on advances to recipients under that project were based on the average monthly balances in three Government of El Salvador "global accounts" which are used to fund all activities under the project.[5] Also, the remaining potential interest of approximately $600,000 was based on interest for 9 of the approximately 50 active subrecipient activities (as of July 1994) which were provided advances from these global accounts. Thus, we believe the methodology used was reasonable for estimating potential interest that could be earned on advances provided under this project.

In regard to the Mission's concern that the auditors' computation assumed the overall advance balances will be the same in the future as they were in

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[5] As shown in Appendix III, one account is for SETEFE (account number 106161) and the other two are for the Secretariat for National Reconstruction (account numbers 143727 and 144774).

the past, this audit report concluded under the first audit finding (see page 3) that USAID/El Salvador generally did limit cash advances to immediate cash needs of recipients. Thus there is no reason to believe (and USAID/El Salvador did not provide any evidence to support) that the amount of cash advances will be significantly reduced in the near future. Furthermore, in our letter to USAID/El Salvador transmitting the draft audit report, we requested that they provide us with an estimate of potential interest that could be earned by having recipients deposit advances in interest-bearing accounts if they did not agree with the $2.3 million. The Mission did not provide any estimate on the amount of interest they thought could be earned by requiring recipients to place advances in interest-bearing accounts.

In response to Recommendation No. 1.2, USAID/El Salvador issued a Financial Management Order establishing procedures for monitoring the interest earned on cash advances to non-U.S. recipients and ensuring that such interest is remitted to the U.S. Treasury. The Mission stated that they do not plan to monitor the receipt of interest from U.S. recipients because: (1) U.S. recipients may remit interest directly to the U.S. Treasury, (2) many U.S. recipients merge advances from several Missions into the same bank account making it difficult for a single Mission to establish a system to ensure interest earned is remitted to the U.S. Treasury, and (3) the Mission judges that verification of compliance with the requirement to remit interest earned to the U.S. Treasury is adequately accomplished through the recipients' annual audit process.

In response to Recommendation No. 1.3, USAID/El Salvador confirmed that one recipient (Medical Services Corporation International) had remitted to the U.S. Treasury $19,833 in interest earned on advances covered in our audit. However, the Mission did not identify any action taken to ensure that the interest earned ($3,858) by the other recipient (Creative Associates) identified in the audit as earning interest has been remitted to the U.S. Treasury.

Based on USAID/El Salvador's response, the three parts of Recommendation No. 1 are considered resolved and can be closed upon our receipt of documentation that the recommended actions have been satisfactory implemented. Regarding the monitoring of interest earned by U.S. recipients, this issue will be addressed in an audit report to the USAID Office of Financial Management by the Inspector General's Office of Programs and Systems Audits. In addition, we will work with USAID/El Salvador to determine what is a reasonable estimate on the amount of interest that can be earned by requiring recipients to place cash advances in interest-bearing accounts.

Does USAID/El Salvador program the local currency generated through its programs to provide cash advances to project recipients in lieu of using appropriated dollars to buy local currency?

USAID/El Salvador did not program the local currency generated through its programs to provide cash advances to project recipients in lieu of using appropriated dollars.

As discussed below, our audit found that USAID/El Salvador should ensure that Economic Support Fund (ESF) monies allocated to SETEFE under the cash transfer program be placed in interest-bearing accounts and take action to provide cash advances to recipients from the local currency generated from these funds in lieu of U.S. appropriated dollars.

Local Currency Should Be Placed in Interest-Bearing Accounts and/or Used To Advance Cash to Recipients

USAID policy promotes that local currency generated under Economic Support Fund (ESF) cash transfer programs be placed in interest-bearing accounts and be programmed for purposes mutually agreed upon by USAID and the host country. However, USAID/El Salvador has not required the Government of El Salvador to place such currency in interest-bearing accounts because USAID/El Salvador officials believed that placing the local currency in interest-bearing accounts would undermine the Government of El Salvador's monetary stabilization efforts. These officials, however, could not provide documentation to support that position, and at the time of the audit they said that this may no longer be a valid position. If the funds were placed in interest bearing accounts, interest earned over the next 24 months (May 1994 - April 1996) could total $3.3 million—money that could be used to carry out the developmental purposes instead of new funds provided by USAID. Furthermore, USAID/El Salvador could probably use the local currency to provide cash advances to recipients and subrecipients in lieu of appropriated dollars. We estimate such financing could save the U.S. Treasury about $1.8 million from May 1994 to April 1996.

Recommendation 2: We recommend that USAID/El Salvador:

2.1 ensure that the Government of El Salvador place Economic Support Funds in interest-bearing accounts; and

2.2 take action to reach agreement and develop an implementation plan with the Government of El Salvador to

use local currency generated under its Economic Support Funds cash transfer programs for providing cash advances to recipient and subrecipient in lieu of appropriated dollars.

USAID Policy Determination No. 18 on "Local Currency" states:

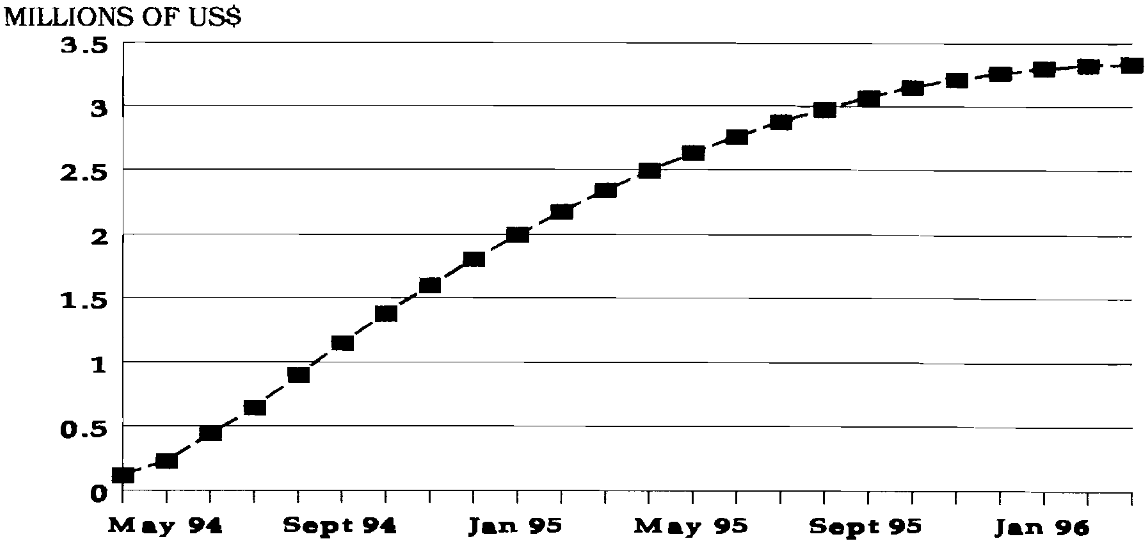
> ...A.I.D. policy favors that local currency be placed into interest-bearing account in a deposit-taking institution, with any interest earned programmed as if it were principal, so long as such accounts are permitted under host country law and regulation and do not undermine internationally-supported stabilization agreements and sound monetary policy.

Under the Memorandum of Understandings between USAID/El Salvador and the Government of El Salvador for the 1992 and 1993 ESF programs, the Government of El Salvador agreed to ensure that each implementing agency deposit the funds in a separate bank account at: (1) the Central Bank or (2) the local banking system if it will not adversely affect El Salvador's monetary policy and targets. Although the ESF Project Paper, dated July 29, 1992, for the 1992 agreement states that local currency funds will not be placed in interest-bearing accounts because placing monies in interest-bearing accounts would undermine stabilization efforts and represent unsound monetary policy, this issue was not addressed in the 1993 ESF Project Paper dated June 11, 1993.

USAID/El Salvador officials said that funds had not been placed in an interest-bearing account because placing funds would undermine stabilization efforts and represent unsound monetary policy. However, the officials could not provide documentation to support this position, and during our exit conference in May 1994, USAID/El Salvador officials noted that economic conditions could have changed which would now allow for the funds to be placed in interest-bearing accounts.

If the local currency of SETEFE's ESF 92 agreement had been placed in the local banking system, it would have generated \$2.7 million of interest from February 1993 to April 1994. And, (as illustrated on page 13) if the funds under the ESF 92 and ESF 93 agreements were to be placed in interest-bearing accounts, there is a potential to generate interest totaling \$3.3 million from May 1994 to April 1996.

Potential Interest To Be Earned
Under ESF '92 & ESF '93 (Cumulative)



In addition to placing the funds in interest-bearing accounts, USAID/El Salvador should consider the use of local currency to be given as cash advances to recipients and subrecipients rather than using appropriated dollars. USAID Handbooks and Treasury regulations do not address this possibility. However, this issue was discussed in a December 1989 audit report[6] by the Regional Inspector General for Audit in Cairo which stated the following:

> Given this availability of substantial local currency resources, we would ask whether it is reasonable and justifiable to burden the American taxpayer with the cost of using dollars appropriated to A.I.D. in order to buy pounds to make advances in support of A.I.D. grant-funded projects with the Government of Egypt.

USAID/El Salvador does not use ESF local currency to provide cash advances to project recipients in lieu of using appropriated dollars to buy local currency. USAID/El Salvador official said they had not thought of the possibility.

We recognize that USAID/El Salvador must reach agreement with the Government of El Salvador to use such currency to replace the appropriated

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[6] "Audit of A.I.D. Advances to the Government of Egypt", Audit Report No. 6-263-90-02 dated December 28, 1993.

dollars used to make local currency cash advances to project recipients. However, given the potential savings of interest costs to the U.S. Treasury, all efforts should be made to reach agreement with the Government of El Salvador. For example, USAID/Egypt reached agreement with the Government of Egypt and by using local currency to make cash advances to Government of Egypt's entities, outstanding advances from appropriated dollars dropped from a two year average during 1987 to 1989 of $10.8 million to only $70,584 as of December 31, 1993.

As it stands, SETEFE is the largest recipient of appropriated dollar cash advances. We estimate that SETEFE will maintain on average about $22.7 million[7] in its ESF account between May 1994 and April 1996. We further estimate that using the local currency under the ESF program in lieu of appropriated dollars during this same period could reduce U.S. Treasury interest costs by $1.8 million.

In conclusion, USAID/El Salvador should place ESF funds in interest-bearing accounts and should reach agreement with the government to use some (or all) of the local currency generated from these funds to replace the appropriated dollars used for cash advances to recipients to lower U.S. Treasury interest costs.

Management Comments and Our Evaluation

USAID/El Salvador generally concurred with the finding and recommendation (Recommendation No. 2.1) for requiring the Government of El Salvador to place local currency generated from Economic Support Funds in interest-bearing accounts. But, the Mission apparently misconstrued the intent of the finding and recommendation (Recommendation No. 2.2) to use the local currency for providing cash advances to recipients and subrecipients in lieu of appropriated dollars.

In response to Recommendation No. 2.1, USAID/El Salvador stated that it is negotiating with the Government of El Salvador for the transfer of the SETEFE funds into interest-bearing accounts. The Mission also officially communicated this audit recommendation to the Government of El Salvador and proposed that the transfer to interest-bearing accounts "be phased in

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[7] The average of $22.7 million is based on the balance ($20.1 million) in the account as of May 1994 and reduced it by $2.1 million per month through April 1996 which was the average monthly disbursement from the account in the past. Also, we considered in our computations the $19.2 million that was added to the account in July 1994 and an estimated $11 million that was expected to be added to the account in September 1994. We recognize that the savings to the U.S. Treasury would accrue sooner if the advances per month to recipients exceeded the $2.1 million.

order to avoid any adverse macroeconomic impact". The Mission, however, did not provide any documentation which supports any "adverse macroeconomic impact" that might result if the transfer to interest-bearing accounts was done at the time of its response—or even sooner—rather than "phased" approach.

In response to Recommendation No. 2.2, USAID/El Salvador stated that it is not feasible to use local currency in lieu of appropriated dollars for providing cash advances to recipients. One reason cited by the Mission is that the available funds in the local currency accounts will not be sufficient to finance both the advance needs of appropriated dollars and the financial requirements of the developments projects approved under the Local Currency Program's Memoranda of Understanding. The Mission also stated that an important consideration is that the Economic Support Fund Program is declining and there is no guarantee when or what future amounts may be allocated to El Salvador.

Based on USAID/El Salvador's response, Recommendation Nos. 2.1 and 2.2 are resolved and can be closed upon receipt of documentation that the recommended action have been satisfactory implemented. However, based on the Mission's response regarding Recommendation No. 2.1 and considering the significant amount of potential interest that could be earned (estimated at $3.3 million from May 1994 to April 1996), we believe the Mission should fully document the "adverse macroeconomic impact" that would require the transfer to interest-bearing accounts be phased in rather than transferred all at once.

Regarding the Mission's response to Recommendation No. 2.2, we consider the recommendation resolved because the Mission considered the potential use of local currency funds for cash advances to recipients but determined there were not sufficient funds to cover both the advance needs of appropriated dollars and the financial requirements of the development projects under the Local Currency Program Memoranda of Understanding. However, the Mission apparently did not fully understand the intent of the recommendation. For example, we did not intend that the Mission had to fund all—or none—of the cash advances to recipients. In our opinion, the Mission could fund just a few advances from the local currency accounts depending on the balances in those accounts and fund the other advances from appropriated dollars. We intend to work with the Mission to resolve any misunderstandings on what is required to close this recommendation.

SCOPE AND METHODOLOGY

Scope

We audited USAID's management of cash advances to recipient organizations in accordance with generally accepted government auditing standards. We conducted the audit from April 18 through April 29 and May 16 through May 25, 1994, at USAID/El Salvador and reviewed USAID/El Salvador's management of cash advances through April 20, 1994.

We obtained computer-generated lists from USAID/El Salvador's computerized Mission Accounting and Control Systems showing outstanding (unliquidated) cash advances (excluding operating expense account advances) as of April 20, 1994, which totaled $61.3 million. We did not verify the overall reliability of this data; however, we verified the accuracy of account balances and related data for recipients selected for detailed review. We judgmentally selected the outstanding advances per recipient over $1 million. It should be noted we selected one recipient which was only $800,000 because the recipient was a government entity. We then reviewed all the cash advances that were made from October 1, 1992 through April 20, 1994 to the recipients identified in accordance with this methodology—advances that totaled $58.8 million.

We did not review if USAID/El Salvador used letters-of-credit to finance recipients in lieu of cash advances. This aspect of the audit work was to be performed in USAID/ Washington.

We examined the internal controls related to each objective and considered prior audit findings applicable to the areas under review.

Methodology

We reviewed 30 vouchers (six consecutive months) for 5 recipients, and we did a cursory review of the remaining vouchers. We chose the 5 recipients with the longest activity and period of bank records. We performed analysis to determine that advances were appropriately deposited by the recipients and subrecipients. Our testing of 30 vouchers did not reveal any significant problems, and we concluded that there were no material and systemic problems with limiting cash advances to immediate disbursement needs.

We also reviewed recipients' agreements with USAID/El Salvador to see if they required the recipients to deposit cash advances in interest-bearing accounts and to remit interest earnings. We determined if USAID had records showing the recipients' earnings. We interviewed USAID/El Salvador personnel to determine how they tracked recipients' interest earnings and discussed the reasons why recipients did not remit earnings. When Treasury check advance recipients did not use interest-bearing accounts, we used the bank statements to determine the interest that should have been earned.

Using an average of the passbook saving rates from October 1992 to April 1994 for accounts in El Salvador which was 7.38 per cent, we divided over 12 months to arrive at 0.00615 monthly interest factor. We used the interest rate of El Salvador because most of the recipients were in El Salvador. For U.S. recipients. we did the same operation except we used 3 per cent for the interest rate or 0.0025 as the monthly interest factor. The justification for this interest cost is we believe that from October 1992 to April 1994 it was a reasonable interest rate to be paid by banks. For the potential interest lost, we used a MACS printout of the months remaining as of April 1994 before the projects were completed.

We then determined if USAID/El Salvador: (1) had non-project assistance programs such as cash transfer and commodity import programs that generate local currency each year and place the local currency in interest-bearing accounts and (2) used appropriated dollars to purchase local currency in order to finance project recipients. We reviewed the Memorandums of Understanding under the Economic Support Funds (ESF) 1992 and 1993 to determine the uses of the funds. We then compared the amount of local currency generated each year with the amount of dollar-purchased local currency advanced to project recipients to see if there was sufficient local currency generations to cover some advances.

For our analysis we only used the local currency which would have gone to SETEFE, we did not include funds that had been designated for budgetary purposes or the Mission trust. For the ESF 93 funds we assumed when the tranche of money would arrive in SETEFE's bank account and added them into the balance. We used a 4 percent (0.00333333 monthly) interest factor which was the Treasury borrowing costs of 1993. We assumed this rate would continue.

USAID

AGENCY FOR INTERNATIONAL DEVELOPMENT
UNITED STATES A.I.D. MISSION TO EL SALVADOR

November 17, 1994

TO: Coinage Gothard, Regional Inspector General
San Jose, Costa Rica

FROM: Henry W. Reynolds, Director

RE: Management Comments for Draft Audit Report on USAID/El Salvador's Management of Cash Advances to Recipient Organizations.

Provided below are management comments which address the two recommendations contained in subject audit report:

RIG Recommendation No. 1.1 "instruct recipients of cash advances to deposit such advances in interest-bearing accounts and ensure that the instructions are followed":

USAID/El Salvador Response:

USAID worldwide policy does not currently require that non-U.S. recipients keep advances in interest-bearing accounts (IBAs). In fact the USAID/W Contracting Office personnel have advised that the Mission would have to obtain a policy exception each time it amends a grant with a non-U.S. PVO in order to require this. Therefore, the Mission's position is that imposing the requirement is optional, but that it would make sense to obtain the exception and impose the requirement in many cases. The Mission has decided in an Action Memorandum approved by the Mission Director dated September 2, 1994 (See Attachment I) to impose the requirement when the size of the advance indicates that the interest benefits will exceed the estimated additional administrative burden on the recipient and the Mission. Factors to be considered are the state of the local banking system, which is rapidly improving, the difficulty of maintaining savings as well as checking accounts, the number of recipients and sub-recipients, the administrative burden on the Mission, and the expected interest earnings.

The Mission has decided to impose the requirement on all non-U.S. recipients whose advance balances in the Mission's accounts consistently exceed $250,000. Since the Mission accounts typically reflect 90 days worth of advance even though the recipients are held to no more than 30 days' needs, this policy would cover all advances whose actual bank balances are $85,000 or more, and some whose average bank balances are even less. The Mission will request that this same criterion be applied to sub-recipients by recipients, including GOES recipients and sub-recipients. The application of the $250,000 ceiling would cover an estimated 99% (43 million) of all local recipient advance balances while affecting 24% (6) of the recipients (See Attachment II). The Mission judges that this is a reasonable and effective alternative to universally applying the requirement to the non-U.S. recipients.

An analysis of outstanding advances determined that the following non-U.S. non-governmental institutions fall into the criteria described above. Accordingly, USAID/ES has taken the following actions:

FUSADES:

On June 30, 1994, FUSADES, the largest advance holder, was instructed to deposit the USAID advances into IBAs. (See Attachment III)

FUNTER:

Amendment No. 8 to the FUNTER agreement signed on June 29, 1994 required the entity to deposit its advances into IBAs. (See Attachment IV)

ADS:

In October, 1994, Mission obtained bank statements pertaining to ADS' advances and determined that requiring ADS to deposit funds into IBAs was warranted. The ADS Director has agreed to deposit the funds in IBA's, a letter to this effect will be sent by November 30, 1994.

FEPADE:

Mission staff met with FEPADE's representative on November 4, 1994 and it was agreed that advances would be placed into IBAs. This agreement will be formalized through exchange of letters.

PROCAFE:

Project Manager is in the process of scheduling a meeting with staff from PROCAFE to discuss the matter.

With respect to government institutions receiving funds originated from dollar appropriations, Mission has started negotiations with the Government of El Salvador (GOES) to require the largest entity i.e. the National Reconstruction Secretariat to keep its advances in IBAs and to impose the same requirement, subject to the $250,000 criterion, on its sub-recipients. The Mission expects these negotiations to result in the collection of interest on these advances and will notify RIG/SJ when the process has been concluded.

RIG/SJ Action Requested

USAID/El Salvador requests resolution of the above recommendation based on the actions completed and in process. Closure of the recommendation will be requested upon completion of the remaining actions in process as described above.

RIG Recommendation No. 1.2 "develop a system to ensure that interest earned on cash advances are remitted to the U.S. Treasury";

USAID/El Salvador Response:

Financial Management Order No 400-22 issued November 14, 1994 (See Attachment V) sets the procedures for monitoring submission of interest earned to the US Treasury. Mission will only monitor the receipt of interest from non-US recipients holding their advances in IBAs. Since US recipients may remit interest directly to the Treasury or through the Mission, and since many US recipients merge advances from several Missions into the same bank account, it would be difficult for a single Mission to establish a system to monitor compliance with this requirement and difficult for many recipients to comply with. However, since the requirement is contained in the mandatory Standard Provisions for US recipients, the Mission judges that verification of compliance with this requirement is adequately accomplished through the recipients' annual audit process.

RIG/A/SJ Action Requested

USAID/El Salvador requests closure of the above recommendation based on the fact that the implementing actions are final.

RIG Recommendation No.1.3 "ensure the $24,072 of interest earned by recipients identified in this report that had not been remitted to the U.S. Treasury is remitted." RIG e-mail dated October 17 adjusted the amount to $20,514.35.

USAID/El Salvador Response:

Medical Services Corporation International (MSCI) confirmed they had earned $20,514.35. (See their letter dated October 24 as Attachment VI). Of this amount, they remitted $19,833.35 directly from their home office to the U.S. Treasury (See Attachment VI). Of the difference of $681.00, $675.00 is attributable to allowable administrative cost associated with processing the interest and the remaining $6.00 Will be remitted to Treasury as promised by MSCI.

RIG/A/SJ Action Requested

USAID/El Salvador requests closure of the above recommendation based on the fact that the implementing actions are final.

RIG Recommendation No. 2.1 "USAID/El Salvador ensure that the GOES place Economic Support Funds in interest-bearing accounts."

USAID/El Salvador Response:

For the sake of more clarity, we suggest that the Executive Summary and page 6 of Draft report include USAID Policy Determination No. 18 in its entirety which reads: "favors that local currency be placed in IBA's ...**so long as such accounts are permitted under Host Country laws and regulations and do not undermine internationally supported stabilization agreements and sound monetary policy."**

As stated in the Action Memorandum dated September 2, 1994, Mission believes that the Host Country Owned Local Currency (HCOLC) Global Account, which holds the generated local currency until it is moved to the SETEFE account for counterpart purposes, should be kept in the BCR since it is not expected to remain there in excess of 30 days.

As to the SETEFE account also kept in the BCR, Mission is negotiating with the GOES the transfer of such funds to IBAs. To this effect a meeting was held on October 28, 1994 between representatives from SETEFE, BCR and USAID to discuss the matter. In that meeting the staff from SETEFE and the BCR pointed out that a) The Organic Law of the BCR does not permit them to pay interest on donated funds; b) GOES stand-by agreement with the International Monetary Fund stipulates that the ESF-generated local currency be recorded on the BCR balance sheet as part of the BCR's net domestic assets; and c) the excess liquidity resulting from favorable coffee prices is already expected to generate inflationary effects in the economy during 1995 and that the transfer of the ESF-generated local currency to the banking system would exacerbate the problem. This would force the BCR to issue more monetary stabilization bonds in order to keep inflation under control which in turn will adversely affect the BCR's equity position.

On November 4, 1994 the Mission officially communicated this audit recommendation to the GOES and proposed that the transfer be phased in order to avoid adverse macroeconomic impact (See Attachment VII).

RIG/A/SJ Action Requested

Based on the actions in process, the Mission requests resolution of this recommendation. Closure will be requested based on either the GOES agreement to transfer the funds to IBAs or an acceptable justification that the measure would have adverse macroeconomic effects.

RIG Recommendation No.2.2 "take action to reach agreement and develop an implementation plan with the Government of El Salvador to use local currency generated under its Economic Support Funds cash transfer programs for providing cash advances to recipient and sub-recipient in lieu of appropriated dollars."

USAID/El Salvador Response:

Mission estimates that an advance fund of approximately $29 million dollars will need to be established from the ESF generated local currency funds to cover advances to recipients and sub-recipients of appropriated dollars. According to the analysis shown in Attachment VII, by the time such fund could be implemented, the HCOLC resources will not be sufficient to finance both the advance needs of appropriated dollars and the financial requirements of the development projects approved under the Local Currency Program Memoranda of Understanding. Also, an important consideration, is that the ESF program is declining and there is no guarantee when or what future amounts may be allocated to El Salvador. For example, the $25 million ESF Agreement expected to be signed in September was not obligated.

RIG/A/SJ Action Requested

Based on the analysis presented in Attachment VIII, Mission views this recommendation is not feasible and request closure accordingly.

With respect to the statement in the Executive Summary of your draft report which reads, "If advances were placed in interest-bearing accounts, an additional $2.3 million in interest income could be earned in the future under current agreements with recipients of cash advances," the Mission judges that the conclusions of the auditors are highly speculative. The Mission's conclusion is based on the following:

1) The auditors'methodology assumes that all activities under Project 519-0394 have the same remaining life as the Project itself, i.e. 36 months, whereas some of them have already terminated and others terminate before the PACD, and therefore will not be receiving advances;

2) The methodology assumes that overall advance balances will be the same in the future as they were in the past. In fact, declining program size will materially reduce these balances in the future. (Local currency funds to cover these advances will also decline, so the recommendation will remain unfeasible.)

APPENDIX III

ANALYSIS OF INTEREST

Recepient	Project	Account #	Avg. Montly Balance ($)	Interest Rate %	Interest that could have been earned	Time left of proj. (months)	Potential Interest to be earned
ADS	519-363	0201-00915-10	323,731	7.38	37,828	15	29,864
FEPADE	519-315	0110555016	185,894	7.38	20,578	41	46,873
		105743009 & 36136129	115,851	3	5,243	41	11,875
CREA	519-320	4420112585	224,561	3	2,247 (3)	5	2,807
	519-320	1203-10490	30,054	7.38	1,848	6	1,109
	519-394	1203-10238	30,721	7.38	2,267	37	6,991
	519-394	4420116438	254,180	3	7,625	36	22,876
MSCI	519-367	1220-01396	75,947	7.38	8,874	39	18,216
		1222-8273	295,272	3	11,387 (2)	40	30,554
FUSADES	519-327	0110562012	88,196	7.38	10,306	5	2,712
		1045413 009 & 3613 6356	119,266	3	5,367	6	1,789
	519-287	522 031238 4	132,359	7.38	12,210	5	4,070
		28-10712-8	23,720	7.38	2,772		
		106708002 & 3613-6364	193,971	3	8,729	6	2,910
SETEFE (1)							
	519-394	**106161 (global)**	2,013,390	7.38	222,882	37	458,147
*SRN	**519-394**	143727	1,766,036	7.38	195,500	36	391,000
		144774	2,965,488	7.38	164,140	36	656,559
	519-320	**115469 (global)**	236,064	7.38	23,229	6	8,711
ANDA	519-320	141044	250,883	7.38	26,230	5	7,715
CONARA	519-320	143958	71,139	7.38	4,375	5	2,188
DGC	519-320	144915	1,291,803	7.38	15,889	5	39,723
	519-333	**115097 (global)**	1,296,568	7.38	143,530	2	15,948
CEL	519-333	128074	13,607	7.38	1,506	2	167
ANDA	519-333	128785	182,943	7.38	19,127		
VMVDU	519-333	129221	6,894	7.38	170		
MINEDUC	519-333	138297	441,508	7.38	48,875	2	5,431
DIS	519-333	138040	163,301	7.38	13,056		
AMSS/GGM	519-333	138388	473,886	7.38	52,459	2	5,829
CEL	519-333	139063	29,480	7.38	3,263	2	363
VMVDU	519-333	129528	4,434	7.38	109		
DGR	519-333	143115	5,934	7.38	511		
VMVDU	519-333	141184	162,575	7.38	8,998		
DGR	519-333	138719	8,801	7.38	487		
VMVDU	519-333	129452	16,306	7.38	100		
MINEDUC	519-333	142729	1,941	7.38	215	2	24
BFA	**519-394**	39171570	73,404	7.38	4,063	36	16,252
PACT	**519-394**	503040817 9	104,211	7.38	11,536	36	23,072
		503040959 0	44,681	7.38	1,374	36	9,893
LAND BANK	**519-394**	144840	1,261,740	7.38	46,558	36	279,349
CRS	**519-394**	1203-10393 & 1203-11239	179,038	7.38	13,213	36	39,639
TECHNOSERVE	**519-394**	0320-02674	87,572	7.38	4,847	36	19,389
		0320-02726	606,519	7.38	3,730	36	134,283
CARE	**519-394**	0103-15620	159,916	7.38	2,950	36	35,405
					1,156,569	**$**	**2,331,733**

* Global accounts of the Secretaría de Reconstrucción Nacional (SRN) which distributes to subrecepients.
SRN receives the funds from Acc.# 106161

(1) The following are subrecepients of SETEFE

(2) Interest earned from 10/92-3/94 and not yet remitted

(3) Interest earned from 1/94-4/94 and not yet remitted

APPENDIX IV

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