United States General Accounting Office

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Report to the Chairman, Subcommittee on Europe and the Middle East, Committee on Foreign Affairs, House of Representatives

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# FOREIGN AID:

# Better Management of Commodity Import Programs Could Improve Development Impact

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GAO

**United States**
**General Accounting Office**
**Washington, D.C. 20548**

**National Security and**
**International Affairs Division**

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September 26, 1988

The Honorable Lee H. Hamilton
Chairman, Subcommittee on Europe
and the Middle East
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

As requested, we have reviewed selected Commodity Import Programs administered by the Agency for International Development (AID) to determine how these programs might achieve greater development impact. The report evaluates the consistency of the programs with AID development strategies, AID monitoring of local currency funds, and the adequacy of program controls in accounting for commodity arrivals, distribution, and end use. We are making recommendations to the Administrator of AID to improve arrival accounting systems and AID monitoring of local currency funds and commodity end use.

We are sending copies of this report to the Administrator, Agency for International Development and other interested parties and will make copies available to others upon request.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Assistant Comptroller General

# Executive Summary

## Purpose

In fiscal year 1987, the United States provided $350 million in Commodity Import Program assistance to address balance-of-payments problems in countries important to U.S. political and security interests. GAO reviewed the programs in Egypt, Pakistan, Zambia, and Zaire to assess how this program could achieve more development impact.

## Background

The Commodity Import Program is a major program component of the Economic Support Fund administered by the Agency for International Development (AID). This program helps countries experiencing foreign exchange shortages to sustain economic activity by financing needed imports. AID missions have installed systems to monitor the arrival, disposition, and end use of these commodities to ensure the items are used promptly for their intended purposes.

Although Commodity Import Programs serve U.S. political and security as well as economic objectives, the Congress has indicated that these programs should support development to the maximum extent possible. Accordingly, the Foreign Assistance Act specifies that recipients should make available for development purposes at least 50 percent of the local currencies generated from commodity sales. The host government and AID mutually agree on how local currency funds will be used.

## Results in Brief

Commodity Import Programs have had positive economic effects in recipient countries. However, some of the assistance to Pakistan and Egypt has been inconsistent with AID's development strategies. Moreover, weaknesses in the management of local currencies in these countries has reduced the amounts effectively directed to support development.

Control weaknesses in systems used to monitor commodity arrivals, disposition, and end use have limited AID's assurance that all commodities are received and used for their intended purposes. Similarly, weaknesses in AID's monitoring of local currencies lessen AID's assurance that these funds are used to support development.

## Principal Findings

### Some Programs Inconsistent With AID's Development Strategy

Commodity Import Programs have helped sustain economic production in countries experiencing foreign exchange shortages. However, GAO found that the programs in Egypt and Pakistan were not fully consistent with AID's development strategy because at least half of the commodities were provided to government-owned enterprises at subsidized prices. AID considers subsidies detrimental to development because they reduce the pressure on these entities to set product prices at market-determined levels. Moreover, the program in Egypt financed some commodities and activities of questionable developmental value.

AID officials in Pakistan and Egypt acknowledged the detrimental effects of subsidies, but said that the political dimension of these programs limits their leverage in moving these programs to achieve greater impact. Officials in both countries believe they can best address the problem of subsidies through their economic policy reform discussions with these governments.

### Additional Impact Possible Through Better Management of Local Currency

To varying degrees, AID missions have participated in the host government's programming of local currencies generated from commodity sales. In Zaire and Zambia, local currencies were programmed to support specific development activities. In Pakistan, AID officials believed that emphasizing programming of local currency would reduce its leverage in economic policy reform discussions. Accordingly, AID consciously minimized local currency deposit requirements. As of January 1987, the government of Egypt had accumulated about $325 million in local currencies generated from commodity sales instead of programming these funds to support development. These practices have reduced the amount of funds effectively used to further development in Egypt and Pakistan.

GAO found that AID closely monitored local currencies in Zaire to ensure that funds were withdrawn according to agreed procedures and were used for the intended purposes. For other programs, AID was not monitoring these funds closely enough to provide such assurances.

## AID Systems Inconsistently Account for Commodity Arrivals, Disposition, and End Use

AID systems for monitoring commodity arrivals, disposition, and end use have been developed on a country-by-country basis and do not consistently account for imported commodities. The systems in Zaire and Zambia tracked the commodities from the time AID obligated funds for specific import transactions until the commodities were sold. By linking financial data on commodity transactions with arrival accounting data, these systems were able to collect complete information on all transactions. Complete information (1) enables AID to know whether shipped commodities were received, (2) reduces the potential for commodity diversions, (3) facilitates AID's selection of commodities for end use checks, and (4) permits AID to determine whether required local currency deposits were made.

In contrast, the accounting system in Egypt started with receipt of shipping documents. Because these documents were not always submitted, the system lacked information on commodities valued at $95 million at the end of fiscal year 1986. Similarly, AID's accounting system in Pakistan contained data on only $16 million of over $100 million in commodity shipments at the end of fiscal year 1986. Data was incomplete because AID relied on Pakistan to account for the bulk of the shipments, and Pakistan did not always forward copies of shipping documents to AID.

AID has not specified the extent to which its overseas missions should monitor commodity end use. In Zaire and Zambia, few if any end use checks were made and, in Egypt and Pakistan, the degree of coverage for end use checks has declined. Moreover, when end use checks showed that commodities were idle or not fully used, AID did not resolve these problems before approving further transactions, and the problems recurred.

## Recommendations

GAO makes several recommendations to the Administrator of AID to improve commodity arrival accounting systems, end use monitoring, and local currency management. (See pp. 24, 25, and 36.)

## Agency Comments

AID commented that corrective measures will be taken or have been taken on GAO's recommendations. In some cases, AID said that it would not be practical to institute worldwide measures because country and program circumstances differ and resources are limited. GAO believes that the actions AID has taken or plans to take will improve accountability and impact of the program.

# Contents

## Abbreviations

| | |
|---|---|
| AID | Agency for International Development |
| CIP | Commodity Import Program |
| ESF | Economic Support Fund |
| GAO | General Accounting Office |

# Introduction

The Economic Support Fund (ESF), administered by the Agency for International Development (AID), is the largest component of the U.S. bilateral economic assistance program. Over the last 6 years, ESF has grown by over 75 percent—from $2.2 billion in fiscal year 1981 to over $3.9 billion in fiscal year 1987. Although ESF may be provided to address U.S. political, security, and economic objectives, the Congress has expressed its intent that AID use these funds to promote development to the maximum extent possible.

AID delivers ESF assistance as project assistance, cash transfers, and/or Commodity Import Programs (CIPs). CIP assistance provides balance-of-payments support by financing specified categories of commodity imports, such as construction equipment, farm equipment, spare parts, fertilizer, feed grains, and petroleum, under loan or grant agreements. AID uses CIPs to deliver ESF assistance when a recipient needs a relatively fast transfer of resources to address foreign exchange shortages. Specific CIP objectives can include (1) reducing balance-of-payments deficits, (2) providing a measure of economic or political stability, (3) generating local currencies for development needs, and (4) promoting economic reforms. Because recipients generally must purchase CIP commodities from U.S. suppliers, CIPs also stimulate U.S. exports.

## How CIPs Work

Responsibility for administering and implementing CIPs is divided among AID bureaus in Washington, AID's overseas missions, U.S.-based suppliers and shippers, and public and private sector importers in the recipient countries.

AID overseas missions are responsible for designing CIPs and preparing the program assistance approval documents justifying the CIP. Once approved by the responsible AID geographic bureau, the mission and the recipient government enter into a formal agreement which provides for disbursement procedures, records maintenance, local currency deposit and use, and inspections.

AID's Office of Procurement in Washington (1) formulates the policies, regulations, and guidelines for CIPs, (2) approves the list of commodities to be imported, (3) assists the grantee in procuring and shipping the commodities, and (4) pays the suppliers.

For public sector CIPs, the host government allocates CIP funds among government ministries. For private sector transactions, participating banks make arrangements with importers for the required local currency deposits before issuing financing documents. When shipping the commodities, the supplier sends the shipping documents to the participating bank which forwards them to the importer so that the items can be cleared through customs.

AID overseas missions are responsible for ensuring that systems are maintained to ensure that commodities are promptly cleared through the port and the host country properly accounts for local currencies and uses them for mutually agreed purposes. The systems are expected to include some end use checking of commodities to ensure that they are being used as intended. To the extent possible, missions are to rely on host country accounting systems to provide this information. However, if these systems are deemed inadequate, the missions are expected to develop their own systems.

The Foreign Assistance Act specifies that, to the extent feasible, CIPs should be used to generate local currencies. CIPs generate local currencies when host governments sell imported CIP commodities provided under grant arrangements. The act specifies that (1) local currency proceeds must be deposited into special accounts and (2) at least 50 percent of the funds must be made available to support development. AID missions participate to varying degrees in the host governments' programming of these currencies and monitor the host government's use of the funds to ensure that the funds are used for the intended purposes.

## Decline in the Use of CIPs

Although CIPs have comprised about 40 percent of all foreign economic assistance since World War II, CIP funding has declined in the 1980s. For fiscal year 1987, CIPs represented 9 percent of the total ESF program. As shown in table 1.1, fewer than 15 countries have received CIP assistance in any single year since 1984.

**Table 1.1: CIP Obligations During Fiscal Years 1984-87**

Dollars in Millions

| Country | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|
| Egypt | $301.1 | $200.0 | $199.7 | $200.0 |
| Fiji | • | • | 1.0 | • |
| Jordan | • | 50.0 | 5.5 | 60.0 |
| Kenya | 21.0 | 25.0 | 14.4 | 14.5 |
| Liberia | • | • | • | 5.0 |
| Madagascar | • | 3.0 | 2.0 | • |
| Mauritius | 4.0 | 2.0 | 1.9 | 1.0 |
| Mozambique | 6.0 | 11.0 | 9.6 | 9.8 |
| Niger | • | 5.0 | • | • |
| Pakistan | 92.0 | 107.2 | 91.5 | 58.0 |
| Seychelles | 2.0 | 2.0 | 1.9 | 2.4 |
| Somalia | • | 27.0 | • | • |
| Sudan | 102.0 | 61.0 | 10.0 | • |
| Tunisia | • | • | 4.8 | 8.3 |
| Zaire | 10.0 | 10.0 | 14.8 | • |
| Zambia | 15.0 | 10.0 | • | • |
| Zimbabwe | 10.0 | • | • | • |
| **Total[a]** | **$563.1** | **$513.2** | **$357.1** | **$359.0** |

[a]Columns may not add to totals because of rounding.

AID officials said that AID has reduced its use of CIP partly because of extensive administrative responsibilities. They cited program requirements for commodity eligibility, shipping, procurement, arrival accounting, local currency management, and end use checks as straining the capacity of AID mission staff to administer CIP programs in some countries.

## Objectives, Scope, and Methodology

Concerned that AID was not achieving development impact from the ESF program to the fullest possible extent, the Chairman, Subcommittee on Europe and the Middle East, House Committee on Foreign Affairs, asked us to review selected programs and recommend how ESF could be made a more effective instrument of economic development. For our review, we selected some countries that receive ESF cash transfer assistance and others that receive CIPs. This report summarizes our evaluation of CIPs. In June 1988, we issued our report on ESF cash transfer programs.[1]

[1]Foreign Aid: Improving the Impact and Control of Economic Support Funds (GAO/NSIAD-88-182), June 1988.

Our objectives for the CIP portion of our review were to evaluate (1) the extent to which AID uses CIPs to promote economic development in recipient countries and (2) the adequacy of controls for ensuring that CIP commodities are used for the purposes for which they are imported and that related local currency funds are used as mutually agreed by AID and the recipients.

In reviewing AID's management of CIP activities for fiscal years 1985 and 1986, we conducted audit work at AID headquarters and the Department of State in Washington, D.C., and at AID missions, U.S. embassies, and importer locations in Egypt, Pakistan, Zaire, and Zambia. We selected these four countries to obtain a cross-section of CIPs. The CIPs in Egypt and Pakistan are the two largest programs that AID administers, while the CIPs in Zambia and Zaire are representative of smaller programs.

To obtain an overview of CIP implementation, we interviewed AID officials in the Bureau for Management, Bureau for Africa, and Bureau for Asia and the Near East and Department of State officials in the Bureau of African Affairs and Bureau of Near Eastern and South Asian Affairs. In the countries we visited, we interviewed the U.S. ambassador, the AID mission director, and other embassy and AID staff involved in managing CIPs. We also met with host government representatives and importers associated with a sample of import transactions that we selected on a judgmental basis.

In reviewing how AID used CIP to support economic development, we analyzed the extent to which (1) recipients' allocations of CIP commodities supported AID's overall development strategy and (2) local currencies generated from CIP commodity sales were being used to support development.

We did not make a comprehensive examination of CIP internal controls. However, we reviewed (1) the systems used to monitor the receipt and disposition of commodities, (2) the actions taken to correct problems identified during commodity end use checks, and (3) the systems used to monitor the deposit and withdrawal of local currencies generated from commodity sales. We also reviewed past AID evaluations, reports by AID's Office of Inspector General, AID's annual reports on internal control weaknesses, and our previous reports. We examined applicable AID regulations and instructions and CIP records at each AID mission. To better understand program implementation, we examined a judgmentally selected sample of commodity transactions in each country, except

Zambia. Our field work in Zambia was limited to following up on a recent audit of CIP by AID's Inspector General.

Our review focused on CIP activities in recipient countries and did not include the activities carried out by AID's Office of Procurement in Washington, including the payment of suppliers.

We conducted our review from March 1987 through February 1988 in accordance with generally accepted government audit standards.

# Greater Development Impact Possible Through Better Management of CIPs

Although CIP assistance is provided primarily to address balance-of-payments problems, the Congress has indicated that to the extent feasible CIP assistance should also support development activities in recipient countries. CIPs have achieved positive development impacts in all of the countries we reviewed; however, some of the assistance to Egypt and Pakistan was inconsistent with elements of AID's development strategies. Moreover, weaknesses in the management and control of local currencies in these countries reduced the amounts effectively directed to support development activities and lessened AID's assurance that funds were used for the purposes for which they were programmed.

## Positive Impacts From CIPs

We found that CIP assistance has made positive contributions to the economies of the countries we visited. By helping to finance the foreign exchange costs of importing raw materials, spare parts, and capital goods, CIPs have helped to stimulate economic activity in countries facing financial crises. CIPs have also supported development activities in such sectors as agriculture and energy, which otherwise might have suffered because of limited host government and private sector resources.

AID officials said that the quick disbursing nature of the CIP makes it a highly effective mechanism for providing balance-of-payments support to developing countries. We found that CIPs have helped to alleviate serious balance-of-payments deficits in Egypt, Zaire, and Zambia and to prevent serious foreign exchange shortfalls in Pakistan. For example, the United States has provided Egypt with over $3 billion in balance-of-payments support through general CIP assistance since 1975. An AID contractor with 10 years of experience with the CIP in Egypt concluded in a 1984 evaluation that the initial CIPs had materially eased the balance-of-payments deficit and helped to instill confidence in the business and import communities. More recently, the program has acted as a safety net for Egypt's still tenuous balance-of-payments situation.

In Zaire, the CIP is implemented through the private sector and finances commodities essential to agricultural marketing and transportation. CIP commodity sales have also generated local currencies that have been used as Zaire's contributions to AID-sponsored development projects. Without the local currencies from CIP and other assistance programs, Zaire could not have met AID's requirement for such contributions.

In Zambia, CIP has financed imports of fertilizer, agricultural equipment, spare parts, and petroleum. A 1987 AID evaluation concluded that the CIP significantly contributed to the agricultural sector and the Zambian economy as a whole, in that (1) CIP imports of fertilizer and agricultural equipment spare parts had significantly increased agricultural production and (2) petroleum imports had relieved a serious foreign exchange shortage, thereby averting a major economic disruption.

In Pakistan, the CIP stimulated development in the agriculture and energy sectors. In the first 5-year program, the CIP financed (1) $375 million in equipment and fertilizer critical to agricultural production, (2) equipment used to rehabilitate and maintain the irrigation systems essential for Pakistan's long-term economic development, and (3) $100 million in imports related to conservation, exploration, production, and distribution of energy resources. Significantly, the CIP financed the equipment necessary to expand Pakistan's energy supply. The shortfall in energy capacity was considered a significant limiting factor for production and economic development.

## CIPs Sometimes Inconsistent With AID Development Strategies

To effectively support AID's development efforts, CIPs should be consistent with AID's development strategy in recipient countries. Major AID objectives worldwide have been to encourage private sector development, reduce inefficient public sector activities, and encourage host governments to allow market forces to determine prices. However, a 1985 synthesis of AID evaluations of CIPs showed that AID did not always target the commodities to those activities supporting its development strategy. The report concluded that AID should more tightly control the eligibility of commodities and importers so that it could direct CIP to activities more directly linked to AID's development strategy.

We found that CIPs in Zaire and Zambia generally supported AID's development objectives because importers were paying for CIP commodities at market rates of exchange. In contrast, some of the CIP assistance to Pakistan was inconsistent with AID's development strategy. For example, although AID has encouraged Pakistan to eliminate agricultural subsidies, CIPs have financed $142 million in fertilizer and $123 million in wheat and cotton imports that government agencies sell to farmers and consumers at subsidized prices. These agencies are able to sell the goods at concessional prices because the government does not charge them the full cost of the CIP commodities. Similarly, local governments and government-owned utilities are permitted to purchase CIP-financed irrigation and energy equipment at less than the full-market value. Such subsidies ease the pressure on these entities to set the prices of products and services at levels necessary to fully recover costs.

AID officials acknowledged that continuation of subsidies is detrimental to development; however, they said they are encouraging Pakistan to adopt more market-oriented policies through their economic policy reform discussions with the government. They also believe that CIP assistance to the agriculture sector through the public sector provides AID with leverage in promoting these agricultural policy reforms.

The public sector CIP in Egypt has also supported activities not fully consistent with AID's development strategy. For example, the CIP has financed equipment which is being used to support desert land reclamation even though AID's strategy is to emphasize development on existing lands. An AID official in Egypt said that studies have consistently shown that land reclamation activities in Egypt are not cost effective.

The CIP has also supported inefficient public sector enterprises even though AID's strategy has been to discourage such activities. Egypt allocated over 43 percent of the value of its fiscal year 1986 CIP to the Ministry of Industry. The Ministry in turn provided the imported commodities to a variety of government-owned enterprises at more favorable exchange rates than private sector importers must pay. These enterprises have also enjoyed more favorable terms for down payments, interest rates, and repayment provisions than private sector importers, all of which place the private sector at a competitive disadvantage vis-a-vis public sector entities.

AID officials said the political dimension of the U.S. assistance program in Egypt has reduced AID's leverage in directing the CIP to support activities more consistent with its strategy. One U.S. official said that because the U.S. assistance program serves multiple objectives in Egypt, AID cannot always forcefully pursue changes which might serve as an irritant in the overall bilateral relationship. For example, AID officials did not believe they could press Egypt to shift any more CIP funds from the public to the private sector, given Egypt's strong preference for public sector activities. Moreover, AID had already changed the program from one that was almost entirely supporting public sector activities to one that is split equally between public and private sector programs. Rather than pursue further changes, AID believes it can best address the problem of inefficient public sector enterprises through its policy discussions with the government.

AID officials in Egypt said that U.S. export interests have also sometimes adversely affected their efforts to make the CIP more developmentally oriented. In one case, AID sought to exclude a commodity used to produce cigarette filters from the program on the grounds that the commodity had little or no development value, however, political pressures brought by U.S. export interests forced AID to retract its objection.

AID officials said that the legislative provision requiring at least $200 million of Egypt's ESF allocation to be delivered as the CIP also reduces AID's leverage in directing the program to support development. Because current legislation permits AID to obligate funds over a 2-year period, AID can theoretically carry over CIP funds into another fiscal year if AID disagrees with a recipient's allocations. However, because of the legislative earmark, AID must obligate all $200 million by the end of the 2 years irrespective of any objections it might have over the allocations. One AID official added that the CIP is intended to address balance-of-payments problems and that such withholding could defeat this objective.

## More Effective Use of Local Currencies Could Extend CIP Development Potential

Section 531(d) of the Foreign Assistance Act specifies that, to the extent feasible, CIPs and other program assistance[1] should be used to generate local currencies and that not less than 50 percent of these funds should be made available to support development activities. According to section 609 of the act, when commodities furnished on a grant basis are sold and local currency proceeds accrue to the host government, the funds must be deposited into a special account. In recent years, the Congress has indicated that AID should examine how these funds could be better managed to extend the development impact of program assistance.

In reviewing local currency programs, we found the following facts:

- The extent to which local currencies are generated from CIPs and the extent to which they are used to support development varied from country to country.
- Missions have participated to varying degrees in the host country's programming of local currencies. The purposes for which local currencies have been programmed vary widely, from support of specific development projects to general budgetary support of host government ministries.

[1] AID generally considers Public Law 480 food assistance, CIPs, cash transfers, and some sector grants as program assistance.

- AID has not placed much emphasis on monitoring the host country's management of local currency funds in some countries, so it often cannot ensure that these funds have been spent for the purposes for which they were programmed.

Over the last 2 years, AID officials have debated the proper role of AID in programming and monitoring local currency programs. October 1987 AID guidance reaffirms the existing policy that allows missions flexibility in how involved they become in programming these funds but emphasizes AID's monitoring responsibilities.

## Variations in the Degree to Which Local Currency Is Generated and Used for Development

Although the legislation states that CIPs should generate local currency "to the maximum extent feasible," we found that disparities exist from country to country in the amount of local currency that CIPs generate. Whereas CIPs in Zaire and Zambia required local currency deposits for all commodity sales, CIPs in Pakistan generated relatively little local currency. In Egypt, the government accumulated over half of the local currency funds generated from commodity sales rather than program them for development.

In Pakistan, AID officials interpreted local currency deposit requirements in ways that eliminated deposit requirements for about $200 million in commodities imported under CIPs during fiscal years 1984 through 1986. These interpretations significantly reduced the amount of local currency that Pakistan made available for development. Specifically, AID excluded

- $89 million in CIP commodities transferred to revenue-producing government enterprises by considering the transactions as transfers rather than sales.
- $112 million in commodities resold by the government enterprises by considering the shipping costs to have been financed from the grant portion of the CIP and the commodities' cost from the loan portion; no local currencies were generated because recipients are not required to make deposits for commodities furnished on a loan basis or for shipping costs.

AID officials emphasized that they did not require local currency deposits on intergovernmental transfers because these transfers do not constitute a "sale" or result in "accrual of proceeds" to the government. Although AID guidance does not clarify whether local currencies are required in such instances, we noted that AID was requiring other CIP recipients, such as Egypt and Sudan, to make deposits on similar transfers. AID officials said that this interpretation was made at a time when

AID was consciously attempting to avoid a large local currency program in Pakistan. AID officials said that a large local currency fund could create conflicts with the host government if Pakistan perceived AID as trying to have too much say in how Pakistan allocated these funds. They believe that such conflicts could damage their efforts to encourage Pakistan to enact needed economic policy reforms.

In Egypt, AID was requiring local currency deposits on CIP commodity sales, but it had permitted Egypt to accumulate, rather than program, a significant portion of the funds to support development. Although AID guidance specifies that sales proceeds should be spent as closely as possible to the time of the import to minimize inflationary or deflationary effects, Egypt allocated only 18 percent of the $145 million in local currencies deposited in the special account in fiscal year 1986 and only 34 percent of the $234 million in local currencies deposited in fiscal year 1987. About 97 percent of these allocations were for development activities. Because Egypt's allocation of local currency funds has not kept pace with the deposits, Egypt had a balance of $325 million in unprogrammed local currencies in the special account as of January 1987.

AID officials, in explaining why Egypt has not programmed these funds, stated that Egypt prefers to finance development activities with project dollars rather than with its own local currencies. As a result, when projects need funds, Egypt sometimes seeks additional U.S. project assistance rather than allocating its own local currencies to finance project needs. For example, at the time of our review, an AID project nearing its completion date needed about $2 million in local currency to complete unfinished construction of 18 village banks and 53 warehouses. Although AID had requested that Egypt finance these costs from the local currency account, Egypt was trying to obtain additional AID funding to finance the unfinished construction. The AID project officer said that if the Egyptian government was not committed enough to this project to complete the construction with its own funds—a small portion of the available local currencies—then AID should not feel an obligation to complete it either.

AID officials said that because both AID and host governments view these funds as owned by the host government, AID can only suggest—not dictate—how recipients use these funds. They pointed out, however, that AID guidance permits wide flexibility in the allowable uses for local currencies in support of development. Local currencies, for example, may be used to (1) support specific development activities such as AID, other donor, and host government projects (2) finance technical assistance or economic studies (3) finance accounting and control-related activities or (4) provide general budgetary support to government ministries associated with development activities. Because of this latitude in allowable uses, AID officials told us that they believed Egypt could program a larger share of these funds to support development.

Because of Egypt's high inflation rate—20 percent in 1986—the cost of this large accumulation of local currencies remaining idle is high in terms of missed opportunities to support development. Liquidating the large accumulated balance of local currencies all at once may be inflationary; however, the development impact of this program could be extended if local currencies were programmed at a rate more commensurate with their generations.

## Local Currencies Programmed for Wide Range of Development Activities

Current AID policy gives individual missions wide latitude in deciding how involved they become in the host government's programming of local currency funds. In the countries we visited, AID's involvement in the programming process varied widely, as did the agreed uses of the funds.

In Zaire, AID has been actively involved in the programming process and has ensured that adequate local currency funds were programmed to cover Zaire's required contributions to AID projects. For fiscal year 1987, Zaire allocated about 64 percent of the available local currency funds to AID development projects. AID officials in Zambia actively participated in programming local currencies and approved allocations to host government as well as to AID development projects. One AID official said that because local currencies represented an important development resource in Zambia, AID had on occasion been able to use its approval of local currency funding for government development activities as leverage to promote needed policy changes.

AID officials in Pakistan viewed their responsibility for local currency programming as trying to influence Pakistan's budget allocations rather than getting too involved in funding decisions to support specific projects. AID's involvement was basically that of participating in general budget discussions with Pakistan officials and attempting to influence Pakistan's budget allocations. AID officials said that in this way, AID helps to ensure that priority development areas continue to be funded.

In Egypt, AID officials and the government agreed on broad categories for which the local currency would be used, and then Egypt periodically submitted lists of activities on which it had spent funds and was reimbursed from the special account. We found that the specific activities listed did not always closely correspond to the broad categories agreed to in advance. One AID official said that the purpose of this process has been to show that Egypt met the requirement for host country contributions to AID projects. As previously mentioned, almost all of the funds that Egypt has attributed in this manner have been for development activities; however, more than half of the available local currency generations remain unprogrammed.

## AID Monitoring Inadequate to Ensure That Local Currencies Are Used for Intended Purposes

AID policy guidance states that AID missions are responsible for monitoring the use of local currency to whatever level AID and the host government program the funds. However, we found that generally, AID is not monitoring these funds closely enough to ensure that they are actually used for the purposes for which they were programmed. The exception was Zaire, where AID closely tracks the deposit, withdrawal, and use of local currencies from the special account. The accounting system used in Zaire (1) enables AID to know whether the proper amount of local currency has been deposited, (2) requires AID's approval before funds are released from the account, and (3) requires project audits to ensure that to local currency funds were used as intended. (See ch. 3.)

In Pakistan, Egypt, and Zambia, AID officials generally regarded local currency management as the host countries responsibility and did not verify the accuracy of the host governments' reports on how the funds were used. None of the AID missions was able to provide documentation showing the actual transfer of funds from the special accounts to development activities. Moreover, none received project reports showing the amount of local currency funds used, and none had installed controls adequate to ensure that local currency reached the intended activities. For example:

- Pakistan withdrew and used local currencies from the special account without providing AID with documentation on how the funds were spent.
- AID officials relied on Zambia to verify project expenditures and did not conduct an independent verification.
- Egypt provided data on local currency expenditures, but AID did not confirm that funds withdrawn from the special account were spent for the specified activities.

In 1985, an AID official in Egypt attempted to confirm the use of local currencies by surveying project officers for 20 projects which were supposed to have received local currencies. Of the 12 project officers that responded, 2 said that their projects had received the full amount of local currency that had been allocated to them; 5 received lesser amounts; 4 did not receive any of the expected funds; and 1 project officer did not know whether the project had received any funds.

In addition to the local currency programs associated with the CIPs discussed in this report, we also reviewed local currency programs associated with ESF cash transfer programs in El Salvador, Jamaica, and Senegal during 1987. We found various control weaknesses in these programs as well. For example, in El Salvador, the government agency responsible for monitoring the use of local currencies conducted audits of all projects receiving funding but could not provide us with documentation to confirm the accuracy of its audits. In Jamaica, officials could not provide us with documentation to adequately support all of the local currency expenditure reports they submitted to AID. In Senegal, AID required such limited information on local currency use that it could not adequately ensure that these funds were used as intended.

Over the last 5 years, AID's Office of the Inspector General has reviewed local currency programs in over 20 countries. These reviews have pointed to weaknesses similar to those we identified. In 1987, for example, after reviewing local currency programs in 10 African countries, the Inspector General reported that in 9 of the countries AID and recipient governments had not established adequate accounting systems and internal controls over local currency proceeds. Weaknesses reported included AID's inability to know how much local currency should have been deposited, whether it was deposited, and whether it was used for the intended purposes. Moreover, subsequent reviews of programs in Latin America yielded similar results.

As a result of AID's 1987 review of internal controls required by the Federal Managers' Financial Integrity Act, 5 out of 17 countries receiving CIP assistance since fiscal year 1984 reported either inadequate procedures to verify that local currency funds were made on time and in the correct amounts or inadequate procedures to verify that local currency disbursements were for the agreed upon purposes. However, the AID mission in Egypt was the only one we visited that reported internal control weaknesses in this area. In its annual internal control statement to the President, AID reported as an agency wide weakness the fact that it had not assessed or tested its controls over AID-generated local currency to determine their adequacy and compliance with AID policy. The statement said that AID planned to include expanded evaluation and testing of internal controls over local currency funds in its 1988 overseas internal control assessments.

Some AID missions have taken actions to improve their oversight of local currency programs. For example, to rectify problems related to the deposit and withdrawal of local currencies from the special account through 1986, AID officials in Zambia (1) signed an agreement with the government of Zambia on local currency use and controls, (2) hired an experienced financial analyst to track and analyze Zambian documents on local currency uses, and (3) assigned AID staff responsibility for monitoring projects using local currencies from the special account. AID officials believe these actions will improve accountability for these funds.

Similarly, during 1986 and 1987, Senegal made $21 million in local currency withdrawals without AID's approval although its cash transfer agreement required prior AID approval. AID officials in Senegal told us that they had not placed enough emphasis on local currency matters and planned to (1) review Senegal's accounting systems for local currency deposits and withdrawals and (2) develop a method for verifying local currency expenditures.

## Proper Role of AID in Programming and Managing Local Currency Funds Debated Within AID

AID officials in the countries we visited, except in Zaire, generally conceded that they did not place much emphasis on local currency programs. Given staff limitations, the officials said AID's first priority was maintaining accountability over appropriated funds, not local currency generations. Because both AID and the host governments consider these funds to be host government-owned, AID officials view management of these funds as a host government responsibility. AID's responsibility, in their opinion, is to monitor the host government's management of these funds.

AID officials in Washington said that local currency programs are problematic in some countries because (1) requiring recipients to spend large amounts of local currencies can be inflationary and can conflict with spending limits to which the governments have agreed with the International Monetary Fund; (2) AID staff is too limited to monitor the deposit, withdrawal, and use of the funds; and (3) recipients view these funds as their own—not AID's—and sometimes resent AID's trying to become too involved in their programming and oversight. They emphasized that, while the Congress is stressing better accountability for local currency funds, these factors inhibit their ability to more closely direct and control these funds.

Over the last 2 years, AID officials have debated the proper role of AID in the programming and control of local currencies. The current policy allows maximum flexibility in how involved AID missions become in programming these funds. AID's Bureau for Policy and Program Coordination reexamined this policy in 1986 to determine if it should be changed to require greater mission involvement in local currency programming. Because a consensus on this issue could not be reached, the Bureau issued supplemental guidance in October 1987, which left in force the existing policy of permitting individual missions to decide the appropriate level of involvement in the programming process. However, the guidance emphasized that each mission's responsibility for monitoring the use of local currencies would expand according to how specific an agreement was reached on the use of the funds. If the mission and the recipient agreed that funds should be programmed for specific projects, the mission then had a responsibility to monitor project expenditures to ensure that funds were used as intended. If, on the other hand, funds were programmed for more general purposes, such as general budgetary support of a specific government ministry, the mission only had to obtain documentation that the funds were transferred to the ministry. In the latter case, the mission would not be required to monitor how the ministry spent the local currencies.

An AID policy official conceded that a heavier monitoring burden will fall on those missions who choose to jointly program local currency funds for specific development activities rather than for general budgetary support of government ministries. However, he did not believe this policy would discourage missions from programming funds to the project level. He said these programming decisions would have to be made on a case-by-case basis according to what AID officials believed was in the best interest of development in individual countries.

## Conclusions

CIPs have made positive economic contributions in countries facing foreign exchange shortages by financing imports needed to sustain production. If the full development potential of CIPs is to be realized, however, the programs should be designed to support AID's development strategy to the extent possible. AID appears to be achieving this objective in Zaire and Zambia. However, the programs in Egypt and Pakistan, which have supplied commodities to public sector activities at subsidized prices, contradict AID's goal of encouraging these governments to eliminate subsidies. Various factors constrain AID from directing these CIPs to activities more consistent with AID development strategies. AID officials acknowledge these inconsistencies with their development strategies and are working to address the problem of government subsidies through their economic policy reform discussions with these governments.

Because the Foreign Assistance Act requires only that CIPs generate local currencies to the extent possible, it is a subjective judgement as to whether AID is achieving this objective. The programs in Zaire and Zambia have generated local currencies which have been used to further these countries' development programs. However, AID's interpretations of local currency deposit requirements in Pakistan reduced the amount of funds available to support the government's development efforts, and AID was unable to convince Egypt to spend accumulated local currency deposits from commodity sales for development purposes.

Recognizing the difficulties AID faces in playing a stronger role in these local currency programs, we believe AID should at a minimum examine how the accumulated funds in Egypt might be effectively used. Although we recognize that liquidating all accumulated currencies in Egypt at once could have inflationary effects, we believe AID needs to minimize this build up by intensifying its efforts to encourage Egypt to spend the currencies at a rate more commensurate with generations.

In view of the diverse circumstances surrounding CIP and other ESF programs, we believe AID's policy guidance permitting flexibility in how involved missions become in programming local currencies is appropriate. We also agree with the emphasis the guidance places on AID's monitoring responsibilities. However, whether the funds are programmed for a specific or more general development purpose, we believe that AID missions need to carry their monitoring responsibilities further than they have in the past. That is, to ensure that funds are effectively supporting development, AID should not only ensure that host governments submit reports on the uses of these funds but should also independently verify these reports, at least on a spot-check basis.

## Recommendations

We recommend that the Administrator of AID

- require missions to independently verify, on a sample basis, host government reports on the uses of local currencies and

- develop with Egypt a plan to liquidate accumulations of local currency funds and program future generation for development at a pace more commensurate with the rate that funds are deposited.

## Agency Comments and Our Evaluation

In May 1987, the Egyptian government moved to unify its foreign exchange rate. At that time, Egypt was seeking to maintain a preferential exchange rate for CIP import transactions rather than accept full unification of the rates. In commenting on our draft report, AID officials said that they had successfully resisted these attempts and that exchange rates in Egypt have been fully unified. They said that, as a result, an exchange rate windfall is no longer available under any CIP transaction in Egypt. We believe elimination of this subsidy through exchange rate unification should serve to encourage Egyptian public sector entities to price goods and services according to market forces. Although further reforms are needed before the favored status of public sector entities is eliminated, exchange rate unification is an important step in permitting Egypt's private sector to compete on a fairer basis with public sector entities.

AID generally concurred in our recommendation that AID missions independently verify host government reports on the uses of local currency and noted that it was consistent with current AID policy requirements. While we agree that our recommendation is consistent with current policy requirements, we found uneven compliance with these requirements. Missions were not always ensuring that audits and field visits were made, host governments were not always submitting required reports, and AID was generally not independently verifying host government reports. We believe AID needs to examine what additional measures it could take to achieve more uniform compliance by its field missions with the stated policy requirements.

Concerning local currency funds in Pakistan, AID officials said that, partly as a result of our review, the mission had issued new instructions to improve its tracking of local currency funds. They also commented that, in response to a recommendation contained in our draft report, they had reexamined local currency deposit requirements to determine whether additional funds could be made available to support development. This reexamination has led AID to conclude that its interpretations of local currency deposit requirements in Pakistan are programmatically sound given the circumstances in that country. Accordingly, we have deleted our original recommendation.

Concerning the large accumulated local currency balance in Egypt, AID agreed with our recommendation and said that Egypt had tentatively agreed to release 350 million Egyptian pounds—about $165 million—from the special account during Egypt's fiscal years 1988-89 for developmental efforts in specific ministries. AID stated that it will continue similar efforts to avoid large accumulations in the future. (See app. I.)

# Internal Control Weaknesses in Accounting for the Arrival, Disposition, and End Use of CIP Commodities

AID missions have installed systems to monitor the arrival and disposition of CIP commodities to ensure that they are used in a timely manner and for the intended purpose. In reviewing these systems, we found the following weaknesses.

- AID's ability to account for the imported commodities varied among countries, depending on whether AID and/or the host government could obtain complete and accurate information on all import transactions.
- In some countries, control weaknesses hampered AID's ability to ensure that local currencies were deposited and withdrawn from special accounts according to agreed procedures and used for intended purposes.
- AID had not established criteria on the extent that its overseas missions should conduct end use checks on commodities imported under CIP.
- Few end use checks have been made in some countries. In the limited number of cases when AID made end use checks, the commodities were generally being used as intended. However, when AID found that commodities were idle or underused, it did not always ensure that corrective actions were taken before approving further transactions. As a result, subsequent end use checks showed continuing problems of underuse.

AID needs to ensure that all missions administering CIPs have arrival accounting systems that are able to track each commodity transaction from obligation of the funds to the commodity's end use and, when commodities are sold, deposit of local currency into the special account. Improved monitoring of withdrawals from local currency accounts and better guidance on the extent to which AID missions should conduct commodity end use checks could better ensure that these funds were being effectively used to extend the development impact of CIPs. When commodity end use checks identify problems, AID should ensure that corrective actions are taken to resolve the problems before approving further procurements.

## CIP Control Requirements

In 1983, we examined AID's administration of CIPs in Egypt, Kenya, Sudan, Zambia, and Zimbabwe and found that AID was unable to adequately account for the arrival, disposition, and end use of CIP commodities.[1] We recommended that AID issue more specific guidance to its overseas missions on monitoring the implementation of CIPs, including arrival accounting and disposition of commodities. In response to this

[1] AID Needs to Strengthen Management of Commodity Import Programs (GAO/NSIAD-84-47), Feb. 1984.

recommendation, AID revised its guidance to specify that commodities should normally be (1) processed through the ports and released from customs within 90 days and (2) consumed or put into use within 1 year from being released from customs. To ensure that these objectives were being met, AID specified that records documenting the arrival and disposition of commodities should show the quantity and condition of commodities received and data necessary for end use investigations. The guidance further specified that arrival accounting data should be tied with information on local currency deposits to ensure that importers made the required deposits. Finally, the instructions stated that AID missions should establish their own arrival accounting and commodity end use monitoring systems if the recipient governments' systems were inadequate to meet these requirements.

## Wide Variance in Ability of Arrival Accounting Systems to Account for Imported Commodities

The AID missions in Egypt, Zaire, and Zambia established their own commodity arrival accounting systems because the host governments had not established systems to adequately account for the arrival and disposition of CIP commodities. In Pakistan, AID established its own arrival accounting system for some transactions but relied on the importers' systems for the majority of the transactions.

We found that the systems AID used in Zaire and Zambia to monitor commodity arrivals enabled AID to track the commodities from obligation of the CIP funds to the use of the commodities and deposit of commodity sales proceeds into special accounts. In these systems, AID recorded the amount of CIP funds obligated for each import transaction and, as a result, could readily identify when shipping data were due. If the importers did not supply the expected data, AID could follow up to ensure that arrival data on each transaction were submitted. In Zaire, AID recorded data for each step in the process through deposit of local currency proceeds from commodity sales into the special account. The system in Zambia was similar, except that it recorded data on local currency deposits in a separate system. Because these systems linked financial data to commodity receipt data, AID could account for all commodities. Moreover, by having complete data on all commodity shipments, AID could determine whether importers had made the required local currency deposits. Our review of selected transactions showed that these systems were accurate and reliable in accounting for CIP commodities.

In contrast, we found that the arrival accounting systems used in Egypt and Pakistan provided an incomplete accounting for CIP imports. The system used in Egypt at the time of our review did not include complete information on all imports because suppliers often did not submit copies of shipping documents. Because AID did not link financial data on transactions that had been made with the data in its arrival accounting system, it could not determine what data was missing from the system, and therefore could not follow up to obtain the needed documents. Data in the system as of September 30, 1986, showed that suppliers had not submitted shipping documents for about $95 million in CIP commodities.

At the time of our review, an AID official in Egypt said that the mission would be able to account for all transactions if it could obtain data showing obligation or disbursement of CIP funds, which it could then link with arrival accounting data. The official said that the mission was developing an automated data system to account for CIP obligations by import transaction and that it would eventually link this system to the arrival accounting data.

The arrival accounting system in Pakistan also starts tracking commodities from the time shipping documents are received. For all equipment imported under the Agriculture Commodities and Equipment Program—about 14 percent of CIP allocations through fiscal year 1986—AID personnel cleared the shipments through customs and entered the arrival data into the system. AID officials believe data is fairly complete for these transactions.

Pakistan is responsible for maintaining an adequate arrival accounting system for all other CIP transactions and for submitting copies of shipping documents to AID. AID officials said that AID had determined that Pakistan's system meets all AID requirements for arrival accounting and therefore were not concerned that Pakistan did not always submit copies of the shipping documents as required. Due to AID's reliance on Pakistan's system to account for the majority of CIP shipments, at the end of fiscal year 1986, AID's data system contained information on only $16 million in commodities although total disbursements were over $100 million. Because data in the system is incomplete, AID cannot use the data to identify commodities for end use checks or to verify that importers made the required local currency deposits.

## Accounting Systems Unevenly Account for Local Currency Deposits and Withdrawals

AID policy guidance states that overseas missions should rely as much a possible on the recipients' systems for accounting for local currency funds. The guidance directs that missions should establish special accounts for local currency but does not specify the procedures they should use to ensure that required amounts are deposited. We found wide variances in the degree to which accounting systems controlled local currency deposits and withdrawals in individual countries. Moreover, some AID missions were not effectively monitoring host country compliance with deposit and withdrawal requirements.

In Zaire and Zambia, AID had adequate systems in place to determine whether importers made the required local currency deposits. The system used in Zaire accounted for required deposits at each stage of the import process. The system traced the deposits to individual bank deposit statements to reconcile the total special account balance. To ensure that importers made the required deposits, AID would not permit banks to issue letters of credit for procurements until the importer made an initial 20-percent local currency deposit. Procedures called for AID to hold commodities at the port until the importer made a 30-percent deposit and signed a promissory note for the remaining 50 percent. The system in Zambia did not have these latter controls; however, it did track the commodities throughout the import process to ensure that required local currency deposits were made.

In contrast, the accounting system in Egypt did not obtain sufficient data from the recipient government to effectively account for local currency deposits. In 1984, we reported that internal controls over local currency generation and deposits in Egypt were inadequate and, as a result, AID could not accurately account for local currencies that should have been deposited into the special account. Although AID established a local currency accounting system to address these problems, we found weaknesses in the system that limited AID's ability to properly track local currency deposits. For example, AID depends on monthly reports from Egyptian banks and the government of Egypt as part of a process that reconciles CIP disbursement data, arrival accounting data, bank deposits, and special account summary statements. However, the government has not provided the required monthly reports during the last 3 years. Consequently, AID officials have tried to collect financial data directly from the banks. Mission officials said this process is time-consuming and ineffective in that AID has not been able to collect complete data on local currency deposits.

To resolve this problem, AID officials in Egypt proposed that the host government make deposits into the special account based on CIP disbursements. This would have shifted the responsibility of accounting for importer local currency deposits to the government. However, the government rejected the proposal as impractical because it did not have sufficient funds to make the deposits before the importers made their deposits. Moreover, requiring importers to pay for the commodities before receiving them would make the CIP unattractive to the private sector.

In Pakistan, AID did not reconcile its arrival accounting data to disbursement data or local currency deposit data and relied entirely on the government to account for local currency deposits and withdrawals. Although AID estimated that local currency deposits of about $53 million should have been required in fiscal years 1985 and 1986 for CIP imports of fertilizer, cotton, and wheat, Pakistan only reported about $18 million in deposits. AID officials said part of this difference was due to procedures previously discussed concerning financing some commodities with loan rather than grant funds and paying shipping charges with grant funds—practices which reduce the amount of required local currency deposits. However, documents that AID collected were inadequate to validate this explanation. AID officials agreed that their records of local currency deposits and withdrawals were incomplete and said that they would take action to obtain information necessary to account for local currencies.

We also found that AID controls in Egypt, Pakistan, and Zambia were inadequate to ensure that recipients withdrew local currencies from the special accounts according to agreed procedures. Moreover, as discussed in chapter 2, AID did not adequately ensure that the funds actually reached the activities they were intended to support.

In contrast, AID controls in Zaire prevented unauthorized withdrawals of local currency because AID officials had to countersign any withdrawals from the special account. AID did not countersign the transfer unless it was for an agreed purpose. In addition, AID required project audits to ensure that the funds were used as intended and permitted these audits to be financed with local currencies from the special account.

## More Effective Use Could Be Made of Commodity End Use Checks

AID requires its missions to conduct end use checks on a sample of imported CIP commodities to ensure that they are used for the intended purpose within a prescribed timeframe—usually 1 year. AID instructions state that the sample is to be based on such factors as commodity type, value, supplier, purchaser, or port but do not specify the extent of coverage that AID headquarters expects. AID delegated the responsibility to develop a program for end use monitoring to its missions.

The effectiveness of end use monitoring in the countries we visited was limited because AID conducted very few checks in some countries. Moreover, when AID identified deficiencies, it did not ensure that actions were taken to resolve the problems before approving further procurements.

### Few End Use Checks Conducted

AID officials in Egypt have periodically conducted end use checks of some CIP imports, which have generally showed that commodities were being used for the intended purposes. However, the percentage of commodities covered by the checks has declined—from 72 percent of the total value of CIP imports during fiscal year 1982 to about 23 percent in fiscal year 1985 and to about 15 percent in fiscal year 1986. In the first 6 months of 1987, AID had initiated only three end use checks and had issued no reports. AID officials in Egypt said that they recognized the value of end use checks but did not have sufficient staff to perform this function, especially since staff had been shifted to cover increased workloads in other areas of CIP management.

In Pakistan, AID conducted end use checks of all items received at the start of the program in 1982; however, only a small quantity of commodities were being imported at that time. Since then, AID's objective for its end use checks has been to cover 15 to 20 percent of the fertilizer and equipment imported by provincial irrigation departments under the Agriculture Commodity and Equipment Program. For this program, AID selected a sample of locations and checked all equipment located within each area. The four reports covering these end use checks, filed between May 1984 and February 1987, did not show the value of commodities checked and, as a result, we were unable to determine whether AID's goal for coverage was met. In general, the reports showed that the commodities were being used as intended; however, as discussed below, some items were underused. AID had not conducted end use checks of energy-related equipment imported under Pakistan's other CIP because Pakistan had only recently begun receiving the equipment.

In commenting on our report, AID officials in Pakistan informed us that they had conducted six end use checks since fiscal year 1984, including a recent check of energy-related equipment. They said that in most cases, AID checked about 50 to 60 percent of the items at storage points and 15 to 25 percent of the items at their point of use. They also said that AID's Office of the Inspector General conducted an additional two end use checks during this same period.

At the time of our review, AID had conducted only one end use check of CIP commodities in Zaire. The March 1987 report indicated that the water pumps and electric generating equipment covered in this check were being used as intended. The total value of these items was $140,846. AID officials told us that they believed additional end use monitoring was needed but that staffing was insufficient. They added that the types of commodities which have been imported thus far—soybeans, jute, and farm equipment—have a minimal risk of being diverted to unauthorized uses. However, the risks may increase now that the CIP is being broadened to include a wider range of commodities and additional importers. The responsible AID official said the mission was exploring whether an additional AID staffperson or contractor could be hired to expand the mission's efforts in this area.

AID staff had not conducted any end use checks in Zambia, but AID hired a contractor to examine the use of fertilizer provided to one government enterprise. AID officials said that the types of commodities imported did not lend themselves to end use checks: (1) fertilizer lost its identity in processing and the final product did not have a high potential for improper diversion, (2) spare parts could not be distinguished from those imported through other transactions, and (3) oil was commingled in the pipeline and was therefore untraceable.

## End Use Checks Show That Some CIP Commodities Are Not Fully Used

The reports on end use checks that we reviewed in Pakistan and Egypt generally showed that the imported items were being used as intended. However, the checks sometimes disclosed that commodities were underused or not used at all. In these cases, the importers promised to consume the commodities or put them to use. We found, however, that in some cases AID did not resolve the problems of idle or underused commodities before approving further imports. As a result, subsequent end use checks disclosed recurring problems.

For example, end use checks conducted in Pakistan during fiscal years 1984-87 disclosed recurring instances of underuse of heavy equipment and workshop equipment imported by provincial irrigation departments. During end use checks in 1984, AID discovered that one irrigation department had not scheduled uses for workshop equipment and another was not using heavy equipment received under the CIP. In the latter instance the equipment remained idle because the department did not have sufficient spare parts for repairs and personnel lacked the skills to operate it. A 1985 AID Inspector General report corroborated these findings in reporting that only $6.9 million of the $17.6 million for equipment and spares purchased primarily for Pakistan's irrigation departments through the end of 1984 had been used. The report said the equipment was idle because (1) buildings for the equipment had not been readied, (2) complementary equipment and trained operators were not available, and (3) the equipment was not suited for the intended tasks. In response to both the end use reports and the Inspector General report, AID said corrective actions would be taken to improve use of the equipment. Despite these assurances, subsequent end use checks in 1986 and 1987 showed that equipment was not being used because it was not designed for the intended job.

We also found recurring problems of underused equipment in Egypt. For example, end use checks in 1979, 1980, and 1984 disclosed that the Cairo governorate was not fully using certain trucks imported under CIP because spare parts were not available and, in some cases, the trucks were not suitable for the intended tasks. Later, in 1986 AID's Inspector General reported that certain equipment was still underused. For example, AID auditors found that the Cairo governorate was not using a significant number of imported garbage trucks valued at $19.3 million because it did not have the capability to repair and maintain them; others were kept in reserve for future use. The governorate had also purchased street sweepers for $907,000; however, 87 percent of those that the auditors checked were not being used because they were not designed for street conditions in Egypt and were easily damaged. At the time of that report, the importer had requested an additional $5 million in trucks and equipment. One letter from AID's Inspector General expressed concern that AID was summarily dismissing problems identified in end use checks and approving further procurements despite well-known and long-standing problems.

During our fieldwork, we examined the use of trucks by the Cairo governorate and found continuing problems. Some trucks purchased more than a year earlier had been sitting idle for an extended period and others had not been used at all. The importer had not obtained license plates for some of the trucks. Egyptian officials told us that some of the trucks were not suited to the tasks at hand and that the governorate planned to modify them so that they could be used. The officials said that the importer did not have enough drivers to operate all the trucks and, as a result, some trucks will likely remain idle.

Although it may be difficult for AID to ensure that all CIP commodities are effectively used, we believe that these recurring problems indicate that AID is not satisfactorily resolving the problems before approving further procurements.

## Conclusions

The arrival accounting systems in Zaire and Zambia demonstrate that it is possible to effectively monitor the arrival and disposition of CIP commodities if financial data on CIP obligations for individual imports are linked to arrival accounting data. Having complete data on all import transactions (1) enables AID to determine whether purchased commodities have been received, (2) reduces the potential for commodity diversions, (3) facilitates AID's selection of commodities for end use checks, and (4) enables AID to determine whether importers have made the required local currency deposits.

An effective commodity accounting system should also permit AID to determine how much local currency should be deposited in the special account and whether the deposits have in fact been made. The system in Zaire effectively tracks local currency deposits and withdrawals throughout the process. Moreover, AID controls were effective in preventing unauthorized withdrawals from the special account and providing assurances that funds were used for their intended purposes. The system in Zambia was effective through deposit of the local currencies but AID did not adequately monitor the accounts to ensure that unauthorized withdrawals did not occur. Inadequacies in both the accounting and monitoring systems in Egypt and Pakistan prevented AID from determining how much local currency should have been deposited, whether it actually was deposited, and whether it was being withdrawn and used for intended purposes. In our opinion, where AID has determined that the CIP's impact can be enhanced through a local currency program, it then has a responsibility to effectively monitor the deposit, withdrawal, and use of the funds. More effective controls could improve assurances that local currencies are effectively extending the development impact of CIPs.

Effective commodity end use monitoring should serve to deter the diversion of CIP commodities to unintended purposes and provide information on whether the commodities are being effectively used. We do not believe these objectives are being met because AID has made few end use checks in some countries and coverage in other countries has declined. To provide the needed level of assurance that CIP commodities are used for intended purposes, we believe AID needs to clarify the extent its overseas missions should conduct end use checks of CIP commodities. In preparing this guidance, AID should consider the dollar value of the type of commodities being imported, the importers involved, and the perceived degree of risk of diversion.

If the impact of CIP assistance is to be maximized, AID needs to ensure that the commodities imported are being put to effective use. Where end use checks have found that CIP commodities were underused or idle, AID has not always ensured that corrective actions were taken before approving further transactions. As a result, the problems recurred. We believe that AID could reduce the problem of underuse of CIP commodities by more effectively using the results of the end use checks to identify and correct the causes of recurring problems before approving further transactions.

## Recommendations

To ensure that AID can adequately account for the arrival and disposition of CIP commodities, we recommend that the Administrator of AID

- require that arrival accounting systems provide a clear link between CIP obligations, commodity receipts, and local currency deposits for all import transactions;
- specify the extent to which missions should conduct end use checks and a minimum level of expected coverage; and
- require missions to resolve problems of underused commodities before approving financing of additional transactions by the importer.

## Agency Comments and Our Evaluation

### Arrival Accounting

In commenting on this report, AID officials in Egypt said that its new arrival accounting system linking financial data to commodity arrivals was installed in November 1987. They said that, since then, the value of transactions not in the system had been reduced to $19 million and that all transactions should be covered by the new system by the end of fiscal year 1988. However, a June 1988 AID Office of Inspector General draft report on CIP assistance to Egypt shows continuing problems in accounting for commodity arrivals. An AID Inspector General official told us that as of July 15, 1988, commodity shipments totaling about $150 million had not been entered into the system.

To improve the mission's monitoring of local currency, AID officials in Egypt said that they would continue their efforts to change the missions' local currency accounting system to provide a direct linkage between AID disbursements and Government of Egypt deposits into the special account.

AID officials in Washington cautioned that requiring systems which link AID financial data to commodity receipts and local currency deposits for all CIP recipients may not be practical for all countries. We agree that (1) country circumstances differ widely among CIP recipients and (2) AID should be receptive to alternative host government accounting systems which are capable of achieving the objectives of CIP arrival accounting—that is, ensuring that CIP commodities are effectively and promptly used for the purpose for which the assistance was made and that required local currency deposits are promptly made to the special account. However, based on our review, we continue to believe that systems linking AID financial data to commodity arrival data are effective in achieving these objectives and should be considered wherever possible. The fact that the AID mission in Egypt has adopted such a system for its annual $200 million program lends credence to its applicability to programs other than the relatively small programs in Zaire and Zambia.

## End Use Checks

AID officials in Egypt said that they would continue discussions with Egyptian officials on how end use checks can be improved. Moreover, they said that they had established a file for problems discovered during end use checks that will prevent importers from receiving new allocations unless they are properly using commodities already received.

AID officials in Pakistan said that the mission was establishing a data system that would make monitoring and end use checking easier. They added that, when commodities are provided to a specific project, when necessary the mission is prepared to withhold additional items until usage problems are adequately addressed.

AID officials in Washington were not in favor of mandating a specific amount of end use checking. They said that, given differing program characteristics and country circumstances, individual missions could best determine the appropriate level of end use checks. However, our review indicates that some missions, when left with such wide latitude, may slight this activity if resources are limited. In our opinion, end use checking is an important control feature designed to ensure that program objectives are being met. We continue to believe that AID should reexamine whether more specific guidance on the expected extent of end use checking is needed to ensure that this activity is afforded the proper attention. (See app. I.)

# Comments From the Agency for International Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

ASSISTANT ADMINISTRATOR

June 30, 1988

MEMORANDUM

TO:: Mr. Frank C. Conahan
Assistant Controller General
National Security and International Affairs Division
General Accounting Office

FROM: AA/PPC, Richard E. Bissell

SUBJECT: GAO Draft Audit Report, "Foreign A.I.D.: Development Impact of Commodity Import Programs Could be Improved," Issued June 1988 (GAO Code 472130)

This memorandum responds to your letter of June 1, 1988 transmitting the GAO Draft Audit "Foreign Aid: Development Impact of Commodity Import Programs Could be Improved" for our comments.

We believe the draft report reaffirms the value of the Commodity Import Program (CIP) and the positive contribution it has made to both short and longer term economic and development efforts in A.I.D. recipient countries. The report's recommendations are constructive and have identified areas where A.I.D. implementation could be strengthened. As outlined below, corrective measures will or have been undertaken in several of the areas identified by the report. However, world-wide measures that establish new or less flexible controls must be carefully weighed against the capacity of missions to implement them and their effect on program objectives.

See comment 1.

Our comments are divided into three parts; (1) comments on the report's recommendations, (2) mission specific comments and (3) specific comments on the body of the report.

Comments on Recommendations

See p. 23.

Recommendation #1: Require missions to independently verify, on a sample basis, host government reports on the uses of local currencies.

A.I.D. concurs with this recommendation which is consistent with existing Agency policy guidance. It is important to recognize that A.I.D. defines "use" to mean a particular activity funded or specific purpose to be achieved by the local currency jointly programmed by A.I.D. and the host country.

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"Use" does not mean last use, such as a "hoe" or a "bag of cement" which the local currency ultimately purchases.

This definition is consistent with the general thrust of the GAO report which states on page 40: "we believe A.I.D.'s policy guidance permitting flexibility in how involved missions become in programming local currencies is appropriate. We also agree with the emphasis the guidance places on A.I.D.'s monitoring responsibilities."

The draft report also recommends that "to ensure that funds are effectively supporting development, A.I.D. should not only ensure that host governments submit reports on the uses of these funds but should also independently verify these reports, at least on a spot check basis." A.I.D. also concurs with this verification aspect of the recommendation. When missions jointly program local currency to support projects, certain reports are required. This is also the case with non-project support (support of a sector, sub-sector or more general budgetary support). In the case of project support, A.I.D. policy requires missions to ensure that periodic audits will be conducted and that periodic field visits will be undertaken to ensure that the project was actually implemented and completed. In the case of non-project support, the periodic reports cover budget allocations over the period of the agreement. These reports enable the mission to assess compliance with agreed priorities and help to ensure that the government accords an appropriate emphasis to priority programs. This assessment can then be used as a basis for making future judgements about local currency allocations.

A.I.D. policy also requires missions to determine that the local currency was transferred or disbursed from the special account to the project account or ministerial budget account. At this point the jointly programmed local currency usually are commingled with other host country-owned local currency.

Recommendation Number 2: Re-examine local currency deposit requirements in Pakistan to determine whether additional local currencies could be made available for development.

See p. 24

Comment: The draft report has prompted such a re-examination. The draft report indicated two areas where this might be done: (1) by including CIP commodities transferred to public entities; and (2) by loan, rather than grant, funding shipping costs (the Government of Pakistan is not required to make deposits for shipping costs or commodities furnished on a loan basis). The latter point will in any case no longer be an issue because the new program is expected

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to be implemented only through grants. Nonetheless, it should be noted that the GOP did not accept applying loan funding to meeting higher "fifty percent" shipping requirements; meeting fifty percent requirements is usually a problem and the only salutory way to do it is through grant funding. As for not including CIP commodities transferred to public entities that do not result in accrual of sales proceeds, we appreciate the report's acknowledgement that the mission's interpretation is consistent with legislative requirements. However, we also believe our justification was programatically sound under the circumstances in Pakistan.

See comment 2.

We believe the draft report confused the relationship between counterpart deposits and economic development impact. In part, the report appears to accept the approach described in Pakistan, of budget support for GOP development budget line items or sectors and for achieving meaningful policy reform. However, this acceptance is overridden by a contradictory view, that a Mission should be obtaining all the deposits it can, even if not required by law (e.g. from loan-financed commodities), and applying such counterpart funds to specific activities. In short, if doing the latter makes sense in a country like Zaire or Zambia, it must make sense for Pakistan.

We submit that this conclusion is unjustified and indeed would undermine the flexibility A.I.D. policies must provide missions in achieving diverse development objectives which vary from country to country. Specifically, where a Mission has a meaningful role, as demonstrated in Pakistan, in helping a country to formulate economic policy reform, the programming of local currency for development budget line items or sectors or related ministries may be more appropriate than individual projects. To date, the Pakistan Mission has been generally satisfied with GOP budget allocations for development activities in light of the limited influence A.I.D. has on the GOP budget process (i.e. local currency which could be jointly programmed in relation to the size of the GOP development budget is very limited). The Report's conclusion that more development is achieved by applying more local currency to more projects, rather than specific budgetary support without regard to the circumstances in a given country, is not supported by any analysis in the report.

Recommendation No. 3: Develop with Egypt a plan to liquidate accumulations of local currency funds and program future generations for development at a pace more commensurate with the rate funds are deposited.

See p. 24.

We concur in this recommendation. USAID/Cairo has reached tentative agreement with the Ministry of International Cooperation and the Ministry of Finance to release LE 350,000,000 from the special account in the Government of Egypt 1988-89 fiscal year for developmental efforts in specific ministries. Similar efforts are continuing to avoid in the future large accumulations.

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Recommendation No. 4: Require that arrival accounting systems provide a clear link between Commodity Import Program obligations, commodity receipts, and local currency deposits for all import transactions.

A.I.D.'s commodity arrival and disposition requirements are contained in Handbook 15 Chapter 10 and Handbook 19 Section 10K. A.I.D. policy and procedures specify that the Borrower/Grantee (B/G) maintain adequate books and records to ensure that commodities financed by A.I.D. are effectively utilized for the purpose for which the assistance was made.

Specific requirements are established in the bilateral agreements and related implementation letters. A.I.D. has the responsibility to evaluate the adequacy of the B/G system and monitor the B/G system and performance through periodic reports, analyses, observations and end-use checks. It is A.I.D. policy to have the recipient country do as much of the work of accounting for host country-owned local currency, and for A.I.D.-financed commodities as possible. Where host country systems are deficient, A.I.D. policy encourages missions to work towards their improvement rather than immediately creating an A.I.D. managed system.

See p. 34.

A.I.D. agreements provide a variety of methods to determine the amount of local currency to be generated and deposited to special accounts. These methods and requirements have been developed to meet the various, and often unique, circumstances of each program or country. We acknowledge the need to monitor local currency generations and amounts deposited to special accounts. However, we do not believe the recommendation is practical to implement world-wide. The generation of local currency is often not linked to either obligations or commodity receipts. Import procedures vary from country to country, e.g., credit programs may delay the generation of local currency. We believe our limited resources can best be utilized in assisting cooperating governments strengthen their procedures and controls and in conducting periodic assessments of B/G systems. As noted in the draft audit report, A.I.D. has identified and reported as an internal control weakness our current procedures for monitoring local currency generations, deposits and uses. As a result A.I.D. intends to expand the evaluation and testing of internal controls over local currency funds during the 1988 internal control assessment of overseas operations. We feel that increased monitoring of B/G performance and better adherance to existing procedures, will meet the objectives of this recommendation.

This recommendation also appears to be based on the premise that all CIPs can, and should, be administered and monitored in a manner similar to that used in Zaire and Zambia. We believe the analysis in the report is inadequate to support this conclusion. More consideration should be given in the report to the possibility that

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such a requirement may be neither feasible, nor necessarily appropriate, for all CIPs. For example, any comparison of Zaire with the other three missions reviewed should give due consideration to program size and complexity versus staffing. Zaire has had twenty years in which to educate counterparts and debug program monitoring. The Zaire program management is labor intensive. A mission such as in the Gambia would have insufficient human resources to conduct similar monitoring.

Recommendation No. 5: Specify the extent that missions should conduct end use checks and a minimum level of expected coverage.

See p. 35.

As discussed under recommendation four above, A.I.D. has considerable existing guidance on commodity end use checks. The commodity management and financial management staffs are aware of CIPs requirements. As the draft audit report indicates, the Missions do undertake reviews, consistent with staffing constraints. Mandating a specific amount of end use checking would not necessarily result in the most productive use of limited staff resources. At some points, such as early in the implementation of a CIP or when a particular area of concern has been noted, frequent end use checks may be useful in identifying and forestalling problems. In general, however, end use checks by missions should only be of sufficient frequency and credibility as to encourage adherence to end use controls by the host government. This level is best determined by each mission from experience. Further comments related to this point are outlined under recommendation 6 below.

Recommendation No. 6: Require missions to resolve problems of underutilized commodities for additional items by the importer.

See comment 3.

We concur in principle that problems with underutilized commodities should be resolved before financing is approved for additional transactions by the importer. However, it may be impossible to implement this recommendation in practice. By the time a problem is discovered, the same importer may already have arranged additional financing. Also efforts may be underway to correct a problem, but long lead times delay receipt of needed parts; consequently, we would not necessarily want to prohibit financing of a new transaction. We believe that Missions need flexibility in developing end use programs that are suitable to the circumstances. The amount of time, money, and effort required to assure optimal coverage needs to be balanced against benefits to the foreign assistance programs by country.

The following are GAO's comments on the Agency for International Development's letter dated June 30, 1988.

## GAO Comments

1. We have printed only part 1 of AID's comments, which contained its major substantive comments on our recommendations. We have made changes to the report where appropriate in response to other technical comments contained in parts 2 and 3.

2. We did not intend to suggest that local currency funds should necessarily be programmed for development projects rather than for budget support of government ministries. We agree that decisions on use need to be made on a case-by-case basis. Rather, we were raising the possibility that additional funds might be made available for Pakistan's development—whether for specific projects or budget support—if local currency deposits were required on intragovernmental transfers as they are in some other AID countries, such as Egypt and Sudan.

3. Clearly, AID cannot be faulted for approving transactions by an importer that AID subsequently discovers is not fully using the commodities. However, we believe it is reasonable to expect that AID should resolve such problems as promptly as possible after they are identified. The problems cited in our report has been recurring for several years without resolution.

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