United States General Accounting Office

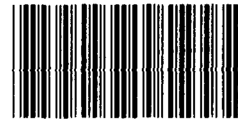
GAO

Report to the Chairman and Ranking Minority Member, Subcommittee on Foreign Operations, Export Financing, and Related Programs, Committee on Appropriations, House of Representatives

November 1992

FOREIGN ASSISTANCE

Cost Reductions Possible From Improved Cash Transfer Management



GAO/NSIAD-93-58

GAO

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

National Security and
International Affairs Division

B-249954

November 18, 1992

The Honorable David R. Obey
Chairman
The Honorable Mickey Edwards
Ranking Minority Member
Subcommittee on Foreign
Operations, Export Financing,
and Related Programs
Committee on Appropriations
House of Representatives

This report responds to your request that we assess the management of legislatively required separate accounts under the foreign economic assistance program administered by the Agency for International Development (AID). As noted in your letter, cash transfers have remained unspent in separate accounts long enough to earn substantial interest for recipient governments. Our objectives were to determine (1) whether AID is applying appropriate cash management practices to minimize federal borrowing costs, (2) the extent of interest earned by the recipient governments and potential savings to the United States, (3) whether options exist for improving AID's cash management practices without detracting from foreign assistance program objectives, and (4) the extent to which AID headquarters is monitoring these separate accounts.

Background

In 1986 Congress first enacted general legislation requiring the deposit of cash transfer dollars in separate noncommingled accounts so that the use of the funds could be traced.[1] This legislation was later extended to cover nonproject sector assistance.[2] The purpose of this legislation was to permit AID to track the use of the funds by preventing the recipient government from commingling U.S.-provided funds with its own funds. The establishment of these accounts also made it possible for the first time to assess the extent of interest earnings by recipient governments on these funds.

AID cash transfer programs provide balance of payments and budgetary support assistance on a cash basis to recipient governments to further U.S.

[1] Foreign Assistance and Related Programs Appropriations Act, 1987, P.L. 99-591 [Sec. 101(f) of the Continuing Appropriations Act, 1987; H.J. Res. 738], 100 Stat. 3341, approved October 30, 1986.

[2] Sec. 592(b) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1990, Public Law 101-167, 103 Stat. 1195, approved November 21, 1989.

national security, economic, and developmental objectives. Cash grants are also made for nonproject sector assistance programs, but these are more narrowly focused on achieving economic and developmental objectives in a specific sector such as agriculture or health.

AID disburses the funds into the separate accounts maintained by each recipient in various commercial banks or the Federal Reserve Bank of New York. The funds are then available to be drawn down by the recipient government to finance imports, repay commercial or official debts, reimburse the recipient for expenses already incurred, or for other agreed upon purposes.

Results in Brief

AID does not apply to cash transfer and nonproject sector assistance programs the cash management principle it applies to other bilateral assistance programs—that funds be retained in the U.S. Treasury as long as possible to minimize federal borrowing costs. Once certain conditions such as political and economic reforms are met, AID disburses the cash transfer or nonproject sector assistance funds into the separate accounts where they become the property of the recipient government. Subsequently, withdrawals are made from these accounts for previously agreed purposes. In the interim, the funds earn interest which, according to the grant agreements, can be used for the same purposes as the principal. Under other AID grant programs, such interest would have to be returned to the Treasury.

Our review of assistance to 22 countries showed that about $228.8 million in interest was earned by recipient governments on about $6.6 billion in cash grants between October 1988 and May 1992. Israel, the single largest recipient, receives its cash grants within 30 days of appropriation and has earned about $162.9 million in interest on $3.6 billion in grants. Poland, another special case, earned about $31.3 million on a $200 million U.S. contribution to a currency stabilization fund.

AID states that often the purpose of providing cash grants is to encourage a country to undertake difficult economic policy reforms and that funds should be transferred to the recipient government as soon as the government meets the specified conditions. However, options exist for improving AID's cash management practices without detracting from foreign assistance objectives. Lower cost alternatives to delivering such cash assistance include (1) direct payment by AID for official debts and for reimbursements for imports or (2) retaining the current practice of

depositing funds into separate accounts but with the interest accruing to the United States.

AID officials in Washington told us they were unaware of (1) the extent to which cash transfer and sector assistance disbursements may have been excess to the amounts required by recipient governments for immediate expenditure or (2) the amount of interest these governments may have earned on the cash grants. Recipient governments are required to periodically report on the expenditures from those accounts to AID country missions or to U.S. embassies, but this information has not been regularly reported to AID headquarters in Washington.

Cash Management Rules Not Applied

AID does not apply the same cash management principles to cash transfer and nonproject sector assistance programs as it applies to other bilateral assistance programs. Treasury guidelines on financial transactions with foreign countries and international organizations stipulate that:

"Funds shall not be withdrawn from the U.S. Treasury for transfer to any recipient prior to the need for the funds. This need is determined by the actual immediate funding requirements of the recipient country or organization. Dollar outlays for international programs requiring [U.S. government] funding shall be made as closely as possible to current program expenditure needs. . . . No part of such funding shall be derived from interest earned on [U.S. government] contributions."

The purpose of this guidance is to minimize federal borrowing costs associated with these programs and to ensure that interest on federal funds is not used to subsidize program activities. These guidelines are an explicit part of AID's overall cash management guidance.

According to AID's guidelines, the preferred method of payment for regular development assistance funds is direct payment to recipients on the basis of goods delivered or services performed or to cover costs already incurred by the recipient. Disbursements are made as needed and generally no cash balances or interest costs are involved.

An exception to the preferred payment method is made for nonprofit and host country governmental institutions, which are normally funded by means of cash advances. These funds are considered federal funds until actually used to purchase goods and services. AID is responsible for assuring that cash advances are not held in amounts in excess of immediate disbursing needs and that any interest earned is promptly returned to the Treasury. Letters of credit can be used for these cash advances. The letters

of credit enable recipients to withdraw funds from the Treasury through commercial bank channels, concurrently with project payments, thereby minimizing cash balances. AID does not consider cash transfers and sector assistance funds to be cash advances of monies belonging to the federal government.

With regard to its cash transfer and nonproject sector assistance programs, AID has interpreted both its own and Treasury's cash management guidance to mean that the "need" for funds occurs when recipient governments adopt the agreed upon policy reforms rather than when the recipient government has "actual immediate funding requirements." This interpretation appears to be the basis for AID's policy that the separate accounts be interest-bearing and that the interest may be used for the same purposes as the principal. AID viewed this policy as consistent with its practices regarding cash transfers before separate accounts were required—namely, that the funds belong to the recipient once the conditions set for their disbursement have been met.

Based on this interpretation of the guidelines, AID, as before, disburses the funds to the recipient government, and the recipient government, as before, invests them in an interest-bearing account. The only difference is that the end use of the funds are now made visible by preventing them from being commingled with other funds belonging to the recipient government.

The establishment of separate accounts also made visible for the first time the extent of interest earnings on these funds by recipient governments. In October 1991, the AID Inspector General noted that Egypt and Panama had earned $3.9 million during fiscal year 1991 on $252 million in cash transfers. The Inspector General suggested that AID (1) assess whether these were isolated cases or a wider scale issue and (2) consider less costly approaches to handling cash transfers more consistent with federal cash management principles, including direct payment and letters of credit.

AID management has not acted on the Inspector General's suggestions; however, AID officials told us that cash management rules that require retaining funds in the Treasury until needed might be difficult to apply to its cash transfers because disbursements are based on the recipient government meeting certain conditions set out in bilateral agreements. These conditions often entail difficult economic policy reforms related to International Monetary Fund and World Bank programs for structural adjustment and financial and sectoral reforms. They stated that any delay

in disbursements might make reaching agreement on policy reforms more difficult and/or more expensive.

AID officials noted that such funds often need to be made available to increase the foreign exchange holdings of the recipient to meet the requirements of the international financial institutions and to maintain the eligibility of the recipient to receive funds from those sources. They were also concerned whether the application of cash management rules might impose additional administrative costs on AID and the recipient and offset any potential savings in Treasury borrowing costs.

AID's Current Practice Adds Costs

Cash transfers and sector assistance funds, like all federal expenditures, affect Treasury's borrowing costs. Funds provided in advance of immediate needs increase the federal government's borrowing costs. Interest earnings by recipient governments on cash transfer and sector assistance funds illustrate that AID is regularly disbursing these funds before they are needed for the purchase of goods and services by recipient governments. If cash transfers and sector assistance funds were managed in a way consistent with Treasury guidelines and AID's cash management guidance, U.S. borrowing costs for financing these programs would be minimized or the interest earnings would be returned to the Treasury to offset those costs.

The unused cash balances in the separate accounts of cash transfer and sector assistance recipients represent funds excess to immediate spending needs. For large amounts, there is a ready market to invest funds for even 1 day, and the Treasury regularly invests federal funds that are excess to those needs. During fiscal year 1991, Treasury earned $1.3 billion from such investments. Overnight deposits are a major source of the interest earnings on cash transfer and sector assistance funds deposited into the separate accounts of recipient governments.

We obtained data on about $6.6 billion in deposits by AID to the separate accounts of 22 countries that earned an estimated $228.8 million in interest over varying periods ranging from 1 day to 940 days between October 1988 and May 1992. The amount of interest earned on deposits into these accounts is shown in table 1.

Table 1: Separate Account Deposits and Interest Earned Between October 1988 and May 1992

Country	Deposits made	Interest earned
Bolivia	$79,625,000	$1,562,405
Cameroon	22,300,000	177,156
Chile	5,800,000	216,485
Colombia	41,000,000	228,087
Costa Rica	159,000,000	610,008
Djibouti	6,042,475	268,802
Egypt	470,000,000	4,722,356
El Salvador	326,665,641	2,176,106
Guatemala	89,500,000	303,499
Honduras	161,000,000	786,130
Israel	3,594,840,000	162,908,200
Jamaica	52,828,500	513,723
Nicaragua	340,500,000	6,774,974
Pakistan	50,000,000	3,463,024
Panama	309,750,000	3,471,601
Peru	20,000,000	101,158
Philippines	401,500,000	3,479,603
Poland	199,140,000	31,315,387
Portugal	131,402,248	3,919,383
Tanzania	21,410,000	663,937
Thailand	9,500,000	344,590
Turkey	64,263,403	827,000[a]
Total	**$6,556,067,267**	**$228,833,613**

[a]Estimate based on deposit and disbursement data and an interest rate of 6 percent.

For 17 of 20 countries (excluding Israel and Poland), we estimate that at least $7.1 million of $34.6 million in interest was earned on $1.3 billion in initial deposits into the separate accounts before any withdrawals were made out of those accounts. The number of days on deposit before any withdrawals ranged from 3 days to 390 days—with the average being 51 days. (Data for the other three countries were not complete enough to make such an estimate.)

The amount of interest earned is affected by the extent to which deposits are excess to immediate spending needs, the amount of time such funds remain on deposit, and the prevailing interest rates. As previously mentioned, interest is earned daily on most accounts. For example:

- The Philippines earned about $3.5 million in interest on $401.5 million in cash transfers and sector assistance grants between August 3, 1989, and

February 29, 1992. This involved 7 different accounts maintained at the New York branch of a Philippine bank and 16 separate deposits by AID into these accounts. These interest-bearing accounts remained open for from 58 days to 940 days with an average of 460 days. Using interest rates provided by the U.S. mission, we estimated that about $1 million was earned before the initial withdrawals from six of the seven accounts. The time between the initial deposits and initial withdrawals ranged from 35 days to 85 days. The funds, including the interest, were used primarily to make payments on official debts owed by the government of the Philippines to the International Monetary Fund, the World Bank, and the Asian Development Bank.

- Egypt earned $4.7 million in interest between July 9, 1990, and November 29, 1991, on $470 million in cash transfers and sector assistance. This involved five accounts maintained at the Cairo branch of a U.S. commercial bank. AID made five deposits, one into each account, transferring the entire agreed upon amount in each case. For one sector assistance grant of $57 million no interest was earned because the funds were used within 1 day to make payments on prior AID loans. The other four cash transfers totaling $413 million were in interest-bearing accounts from 22 days to 165 days and an average of 103 days each. The amount of time from deposit to first payment out for these accounts ranged from 4 days to 94 days. During this time, Egypt earned $1.5 million in interest. Egypt used these funds primarily to pay debts to commercial banks and the Commodity Credit Corporation for food imports.

- El Salvador earned about $2.2 million in interest on about $326.7 million in three cash transfers between June 30, 1989, and February 5, 1992. This involved the establishment of 11 separate accounts at 4 commercial banks in the United States and 26 separate deposits into these accounts by AID. These interest-bearing accounts remained open from 176 days to 302 days and an average of 240 days. The time between initial deposits and the first withdrawals ranged from 3 days to 70 days. Using a range of interest rates provided by the U.S. mission, we estimated that at least $828,000 of the total $2.2 million in interest was earned before any payments out were made on the initial deposits. The funds were used primarily to finance imports.

The total amount of interest being earned in these such accounts is likely to be even greater than the $228.8 million because our review covered only the interest on $6.6 billion provided to 22 countries. AID has provided an

additional $2.2 billion in cash transfer and sector assistance to these and 35 other countries between October 1988 and March 1992.

By law,[3] Israel, the single largest recipient of cash transfers, receives its cash transfers within 30 days of their being appropriated. Like cash transfers to other countries, the funds are deposited into a separate interest-bearing account. The account is maintained at the Federal Reserve Bank of New York. Israel uses the funds to pay amounts due on obligations to the U.S. government. According to Israeli government reports submitted to AID, the interest earnings on $3.6 billion in cash transfers made between November 1988 and October 1991 totaled $162.9 million.

Poland is another special case. In early 1990, AID, pursuant to its appropriation act for that year,[4] allotted about $200 million in Economic Support Funds to the Treasury Department to establish a Polish stabilization fund in cooperation with other donor countries. The fund is maintained in the Federal Reserve Bank of New York. While none of the principal has been drawn down, Poland receives all the interest earnings for its discretionary use. According to Treasury Department officials, Poland earned over $31.3 million from the U.S. contribution as of May 29, 1992, and had withdrawn $9.1 million of that amount. A Polish government official told us that the interest withdrawn so far has been used to pay for technical assistance relating to such areas as bank restructuring and that future withdrawals will be used to help establish an export credit agency.

While the legislation appropriating the funds for Israel and Poland did not specifically state that the United States must provide such interest earnings, congressional hearings indicate that some Members of Congress recognized that these two countries would earn interest on the cash assistance.

Lower Cost Options Are Available

Lower cost options to delivering such assistance include (1) direct payment by AID for official debts and for reimbursements for imports or (2) retaining the current separate accounts, but with the grant agreements specifying that the interest will accrue to the United States. The use of option 1 would eliminate the possibility of additional U.S. spending for interest caused by premature disbursement of the assistance. Option 2

[3]Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1993, P.L. 102-391, approved October 6, 1992.

[4]Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1990, P.L. 101-167, 103 Stat. 1195, approved November 21, 1989.

would mitigate the cost of premature borrowing by returning to the Treasury any interest earned on funds held on deposit.

The first option of direct payment affords the strongest control over the use of the funds. It could be adopted where the funds do not have to be counted as part of the foreign exchange reserves of the recipient government to meet balance of payments objectives and where the number of payments is relatively few to keep AID administrative costs down. For example, Portugal earned $3.9 million in interest between April 6, 1989, and February 26, 1992, on three cash transfers totaling $131.4 million. These funds were used primarily to make payments on debts owed to the Commodity Credit Corporation, AID, the World Bank, and other official institutions. The last of the 3 cash transfers involved 1 deposit into the separate account on July 9, 1991, and 57 withdrawals made between July 16, 1991, and February 26, 1992, to pay these financial institutions. If AID had made these payments directly, the U.S. government could have reduced its financing costs by an amount close to the $776,491 in interest.

The second option of retaining the current separate accounts, but having the interest accrue to the United States, could be used where a relatively large number of payments is involved and/or the immediate availability of the dollars is central to achieving program objectives. This option might be the only viable one in those cases where the funds must be used to augment the foreign exchange reserves of the recipient to achieve balance of payments objectives. For example, in El Salvador, the cash transfer program involved reimbursing that government for payments made to commercial banks for financing import transactions. There were over 5,200 separate import transactions under that program from October 1988 to February 1992. Under these conditions, direct payment by AID would not be practical.

El Salvador is also a country where balance of payments objectives might require the use of the funds to augment that government's foreign exchange reserves. By retaining the separate accounts but requiring that interest earnings accrue to the U.S. government, about $2.2 million would have been returned to the Treasury.

Both options could maintain separate accounts and, under either option, AID would be able to track the use of the funds. Both options would allow AID flexibility in providing funds when recipients have met policy reform or other conditions under bilateral agreements. In commenting on this report, Treasury indicated that its current asset management reviews and analyses

may identify other alternatives to ensure good cash management practices and reduce the interest cost to the U.S. government.

AID Officials Unaware of Total Interest Earned by Recipient Governments

AID officials in Washington told us they had not been aware of (1) how much cash transfer and sector assistance disbursements exceeded the immediate funding requirements of recipient governments nor (2) the amount of interest earned. AID headquarters disbursed the funds into legislatively required separate accounts in commercial banks or the Federal Reserve Bank of New York. The recipients were required to report at least quarterly on the status of those accounts to AID country missions or to U.S. embassies. The missions are supposed to reconcile the host country's accounting records with its own, and the accounts are supposed to be audited at least annually. This information has not been regularly forwarded to AID headquarters in Washington nor is there any requirement for the missions to do so.

Central reporting of this information, which is already required to be gathered by the overseas missions, could improve AID's oversight and management of these separate accounts without adding significantly to AID's administrative burdens. In the absence of such information, AID headquarters lacks a management oversight tool that could be used to assure that funds in the separate accounts are being used in a timely manner for agreed upon purposes, to spot programs that are experiencing delays in implementation, and to provide Congress with more complete information on the total of assistance being provided to recipient countries.

Recommendation

We recommend that the Administrator of AID (1) require the use of whichever lower cost option is consistent with the purpose and objectives of each transfer, (2) justify any exemption from the use of the lower cost option on a case-by-case basis, and (3) adopt standardized requirements for periodic reporting on the status of separate accounts to AID headquarters in Washington.

Agency Comments and Our Evaluation

The Department of the Treasury and AID commented on a draft of this report. Treasury generally agreed with our recommendations and said it would work with AID to identify alternatives to ensure good cash management. AID agreed that U.S. borrowing costs could and should be reduced whenever policy and operational considerations permit, although

it noted that its current practice is not inconsistent with law or regulations concerning cash transfer programs. AID indicated that, in general, its present disbursement regimen for cash transfers is cost effective, administratively simple, and appropriate for foreign policy objectives. Nevertheless, AID stated it would seek to reduce costs by recapturing interest when advantageous from total cost and foreign policy standpoints. In such cases, it would prefer the option of interest earnings being paid directly from the separate accounts to the U.S. Treasury. AID stated it would be desirable to have its missions regularly report to AID headquarters on the separate accounts. Moreover, AID said it plans to issue in the near future a policy statement setting forth the precepts for cash transfer disbursement mechanisms.

Based on these comments we would expect AID to take action to reduce U.S. borrowing costs related to its cash transfer programs. We agree that foreign policy and operational considerations may at times prevent the agency from using a disbursement option that minimizes or mitigates the U.S. governments borrowing costs; however, we believe that this should be the exception rather than the rule. AID and Treasury's comments are presented in their entirety in appendixes I and II, respectively.

Scope and Methodology

We obtained data on AID obligations for cash transfers and nonproject sector assistance programs from October 1, 1988, to March 1, 1992. We then selected programs that provided us with an opportunity to review the management of separate accounts under a variety of conditions, including both large and small programs in various regions of the world used to finance imports or repay international debts. Through electronic mail and by cable, we obtained data from AID missions and U.S. embassies concerning the separate accounts, including deposits, withdrawals, and interest rates and earnings.

We also reviewed legislative history, financial and program documentation, and met with officials at AID and at the Department of the Treasury, Washington, D.C. We reviewed AID nonproject assistance guidance as well as AID and Treasury guidance on cash management and on financial transactions with foreign governments and international organizations. We conducted our review from February to August 1992 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Administrator of AID, the Secretary of the Treasury, the Director of the Office of Management and Budget, and other interested congressional committees. We will also make copies available to others on request.

Please contact me on (202) 275-5790 if you or your staff members have any questions on this report. Major contributors to this report were Lawrence L. Suda, Assistant Director; Douglas P. Toxopeus, Evaluator-in-Charge; and Frederick J. Barrett, Evaluator.

Harold J. Johnson
Director, Foreign Economic
Assistance Issues

Comments From the Agency for International Development

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

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

OCT 1 6 1992

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and
International Affairs Division
United States General Accounting Office
441 G Street, N.W., Room 5055
Washington, D.C. 20548

Dear Mr. Conahan:

We hereby acknowledge receipt of your letter dated September 10, 1992, to Dr. Ronald W. Roskens, Administrator of the Agency for International Development (A.I.D.), in which you requested A.I.D.'s comments on the draft GAO report entitled FOREIGN ASSISTANCE: Cost Reductions Possible From Improved Cash Transfer Management (report number GAO/NSIAD-92-318).

We agree that U.S. interest costs could and should be reduced whenever policy and operational considerations permit. We believe that any examination of saving in interest costs should include administrative costs and foreign policy consideration. At this time, except for the two special cases cited in the report (Israel and Poland), A.I.D.'s present disbursement regimen for cash transfers is cost effective, administratively simple, and appropriate to the foreign policy objectives it is used to serve, although further cost reductions are being sought.

We wish to note that the Draft Report finds that A.I.D. acted in accordance with cash transfer law and regulations as currently in force; the report is suggesting that different cash management procedures be adopted to lower the U.S. Treasury's cost of borrowing the money for cash transfer assistance. In this same regard, it is important also to note that by making cash disbursements under nonproject sector assistance programs A.I.D. is using those funds to achieve specific foreign assistance objectives. Thus, the use by the recipient government of the dollar assistance to pay debt or procure commodities is not considered "financing" by A.I.D. of the debt or the commodities as is the case in project assistance or commodity import programs. This distinction is recognized in the existing separate account legislation, section 571(b)(2) of the FY 1993 foreign assistance appropriations act.

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We agree with your observation that the two special cases, Israel and Poland, account for the lion's share of the borrowing costs cited in the Draft Report: $3.8 billion, or 55 percent of the Cash Transfer volume examined, and $194 million, or 85 percent of the interest reported. Other big interest earners in this period were Pakistan and Portugal.

See comment 1.

Israel is a special case because the relative size of the assistance is large and its final disbursement rate is relatively slow. As you know, Israel is by legislation a special procedural case as well, as the Appropriations Act has mandated disbursement within 30 days of enactment. This provision has had the overwhelming support of the Congress, and legislative history as well as common sense indicate that the Congress is aware of the recipient earning interest on the Grant. If attempts were made to change the law, there would be strong resistance in Congress.

Poland is a different type of special case, where the money originally appropriated to A.I.D. was transferred to the Treasury Department which manages the currency stabilization funds benefitting that country. The success of that stabilization fund to date is remarkable, and it is likely that these monies will not need to be expended. Thus, the opportunity cost to the U.S. is the interest needed to borrow these monies. While A.I.D. is not a direct party to this arrangement, we would note that the psychology of a large currency stabilization effort is often crucial to success.

See comment 2.

Putting aside the special cases of Israel and Poland, the deposits remaining are $2,762 million and the interest earned in the period is some $34.5 million. The interest earned as a percent of these deposits is approximately 1.25 percent. For most of the recipient countries, the present cash transfer arrangements are competitive in terms of cost of administration. Half of the countries earned 1 percent or less of assistance given. If letter of credit procedures are used, the standard bank charge is one percent of the L/C amount. We therefore believe that the cash transfer arrangements for these countries are businesslike and the total cost is not markedly different in outcome than standard federal cash management procedures even though cash transfers are for foreign policy reasons disbursed directly to the grantee instead of to the ultimate payee. We would also note that if interest rates on overnight Federal Funds were to persist at today's rate (about 3 percent), the amounts earned by the grantees would likely be less than the cost to A.I.D. of making direct disbursements.

In summary, we believe that A.I.D. has been correctly implementing the law which provides for cash transfers and for separate accounts for the dollars so transferred, and that the A.I.D. policy requirement that these funds held by the grantees should be interest-earning is reasonable and prudent, as is the

requirement that interest earned be used for the same purposes as the cash transfer grants.

We agree that it would be desirable to have field units transmit regular reports of interest earned by the grantees on their special accounts to AID/W headquarters since this data is easily available in our decentralized offices; presently, field units reports on this only on an exception basis.

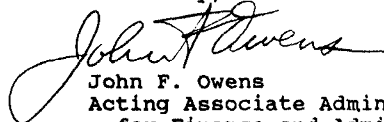
See comment 3.

To the extent that it is advantageous from total cost and foreign policy points of view to recapture interest earned by the grantees, we would prefer, for foreign policy reasons, to arrange for the creation of special accounts that would provide for net interest earnings to be paid directly to the U.S. Treasury. This allows the funds to be used by the grantees in the foreign exchange calculations of the IMF, and could allow capture of the interest in cases where the disbursement schedule is mandated by law should legislation permit. It would also minimize A.I.D. involvement in the often voluminous business of direct disbursement. However, we believe, for the reasons given herein, that it is important that we be able to use the present cash transfer disbursement mechanism when appropriate.

We plan to issue an A.I.D. policy statement setting forth precepts for cash transfer disbursement mechanisms. This policy statement will be made soon after the issuance of your final report on this subject.

We are pleased to have cooperated with your staff in the course of their work and look forward to receipt of your final report.

Sincerely,



John F. Owens
Acting Associate Administrator
for Finance and Administration

The following are GAO's comments on the Agency for International Development's (AID) letter dated October 16, 1992.

GAO Comments

1. Our report makes quite clear that Israel and Poland are special cases.

2. Direct payment by AID may be justified in only a few cases. The use of letters of credit may be restricted by the cost considerations cited by AID and the limitations cited by Treasury, and we have revised our report accordingly. However, the option of maintaining the present separate accounts with interest paid directly to the Treasury on a periodic basis affords a low-cost way to recover these earnings. AID would incur little administrative cost by simply stipulating in future grant agreements that the interest be paid directly to the U.S. Treasury.

3. We agree that this option would be the generally preferred one for the reasons cited.

Comments From the Department of the Treasury

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

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

OCT 21 1992

Mr. Frank C. Conahan
Assistant Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Conahan:

We appreciate the opportunity to review the September 1992 draft report, "Foreign Assistance - Cost Reductions Possible From Improved Cash Transfer Management" (GAO/NSIAD-92-318), which you sent to Secretary Brady on September 10. Our comments deal with Treasury efforts to insure good cash management within the Federal Government and with the impact specific limitations may impose on achieving the desired economic impact of certain foreign economic assistance programs. The comments reflect the views of two Treasury components, the Fiscal Service and Office of the Assistant Secretary for International Affairs.

We generally support the recommendations found in the General Accounting Office (GAO) draft report. Specifically, we agree that the Agency for International Development (AID) should require the use of whichever lower-cost option is consistent with the purpose and objective of each AID program. Our Financial Management Service (FMS) will work with AID, when circumstance warrant the use of current separate accounts, through its CAMRA (Current Asset Management Review and Analysis) Reviews and other means to specifically identify alternatives and determine the best option to ensure good cash management practices and to reduce the interest cost to the Government. This is consistent with the agreement reached at the meeting between representatives of GAO and FMS. Plans to begin the CAMRA Review are underway and results of the review are expected to be ready to be discussed in June 1993.

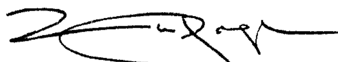
See comment.

In the section Lower-Cost Options Are Available the report suggests that an irrevocable letter of credit might be used which allows the face amount of the letter of credit to be counted as part of the recipient's foreign exchange holding. We must disagree that this is possible. The International Monetary Fund's 1977 Balance of Payments Manual, accepted as the standard in determining whether funds qualify as reserves in the international community stipulates the following with regard to the requirement for Governmental control over reserves:

> 445. ... As a general rule, only foreign claims actually owned by the central authorities would be found to form part of the reserves. ...

As the FMS moves forward with its CAMRA Review for AID, Michael Dressler should be the point of contact. He may be reached at (202) 874-6705. If you have any questions concerning the limitations certain conditions may impose which would not be consistent with the intended economic impact of certain foreign assistance programs you should contact Robert Banque, OASIA, at (202) 622-0767.

Sincerely,



Marcus W. Page
(Acting) Fiscal Assistant Secretary

The following is GAO's comment on the Department of the Treasury's letter dated October 21, 1992.

GAO Comment

In view of the International Monetary Fund's standard, we agree that letters of credit are not a viable option for this purpose and have revised our report accordingly.

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