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REPORT TO THE CONGRESS

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Progress Made Toward Independent And Comprehensive Audits Of The Inter-American Development Bank

B-161470

Department of the Treasury

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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JULY 20, 1971

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-161470

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on the progress made toward independent and comprehensive audits of the Inter-American Development Bank, an intergovernmental financial institution in which the United States holds membership.

Our review was made pursuant to section 14(c) of the Inter-American Development Bank Act, as amended (81 Stat. 226).

Copies of this report are being sent to the Director, Office of Management and Budget, and to the Secretary of the Treasury.

Elmer B. Staats

Comptroller General
of the United States

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D I G E S T

WHY THE REVIEW WAS MADE

The Inter-American Development Bank makes loans and provides technical assistance for the economic development of its Latin American member countries. Its operations are financed principally by contributions from members and borrowings on the open bond market.

The Bank has 23 member countries, one of which, the United States, has contributed 76 percent of all members' financial support.

U.S. membership in the Bank was authorized by the Inter-American Development Bank Act, approved August 7, 1959. The Bank was established by international agreement that same year.

The act was amended in 1967. Among other things, it directed the Secretary of the Treasury (the U.S. representative to the governing body of the Bank) to work toward independent and comprehensive audits of the Bank.

It directed the Comptroller General to prepare a scope of audit and auditing and reporting standards for use in formulating the terms of reference for the audits, to review periodically audit reports issued, and to report to the Secretary of the Treasury and to the Congress on his review of the reports.

This is the first report by the General Accounting Office (GAO) since the 1967 legislation.

FINDINGS AND CONCLUSIONS

In January 1968 the Comptroller General transmitted to the Secretary of the Treasury the required statement on the scope of audit and the auditing and reporting standards. This was the basis for a statement of basic guidance and standards on the establishment and operation of the audit program approved by the Bank's Board of Executive Directors in March 1968.

JULY 20, 1971

Implementation of the program was begun in October 1968 with the creation of a staff called the Group of Controllers of the Review and Evaluation System. The Group is independent of the Bank's management; it is responsible to and derives its working instructions from the Bank's Board of Executive Directors.

To date, the Group has issued three reports.

Study of Sources and Uses of Funds, dated August 1969 (forwarded to GAO in April 1970).

Report on Loans to Venezuela, dated July 1970 (forwarded to GAO in December 1970).

Evaluation Report on Bank Operations in Paraguay, dated November 1970 (forwarded to GAO in February 1971).

NOTE: The Treasury Department has advised GAO that there will be a normal delay of a few months in making the Group's reports available to GAO; the reports will be made available only after the Bank's Board of Executive Directors has accepted the report, at which point it becomes formally available for distribution to member governments.

The Group's third report was not included in GAO's current review because it was forwarded after GAO had completed its review of the first two reports and had sent a draft report thereon to the Department of the Treasury for comment.

GAO believes that the issuance of the reports by the Group represents a positive step toward implementation of a program of independent and comprehensive audit of the Bank. To date, however, the Group's productivity has been limited, in part, because of its small staff. GAO believes that the staff, which consists entirely of economists, should be expanded. GAO believes also that, to complement the Group's expertise, it would be desirable to recruit persons from varied academic disciplines and professional backgrounds. (See pp. 9 to 11.)

The first two reports issued by the Group have deficiencies in either substance or format, which severely limit the reports' usefulness as management tools. Treasury Department and Bank officials were aware of these deficiencies and indicated that they expected considerable improvement in future reports.

Study of Sources and Uses of Funds

This study is basically an accumulation of statistics and data from the Bank's annual financial reports. The study appears to be best suited for use as an internal working document and as such was probably a necessary initial step by the Group members in orienting themselves and assembling basic data which presumably will be useful to their later work.

The study may have been a necessary exercise, but it falls considerably short of being the concise, accurate, analytical examination required by the basic guidance and standards which were adopted by the Bank's Board of Executive Directors. The study suffers from two basic deficiencies--inadequate scope and unsupported conclusions. (See p. 12.)

Report on Loans to Venezuela

This report is a comprehensive, detailed study of all the Bank's loans to Venezuela, with description and analysis of their impact on the country's economy. The report represents an analytical examination, as required by the basic guidance and standards, but loses most of its potential usefulness because of its lack of organization and sheer size--190 pages of text and 91 pages of statistical appendixes. It consists principally of a narrative on the various activities that were examined.

This report contains many good points. They are not, however, summarized, highlighted, or even identified except as can be gleaned from the detailed text of the report. A statement of the scope of work is lacking and the support for statements made in the report is not always evident. Thus it is difficult for a reader to judge the veracity and reliability of statements made.

GAO believes that the report would have better met the basic guidance and standards and would have been more useful to the busy managers and executives for whom it was intended if it had been organized and concisely written in terms of its findings and recommendations for corrective action. (See pp. 16 to 19.)

Evaluation Report on Bank Operations in Paraguay

This report will be analyzed by GAO in the future. The report was accompanied by a brief which appeared to be an excellent summary of the findings and recommendations for corrective action. Also the brief will need to be analyzed by GAO in the light of the report itself, but, on cursory review, it appears to be a useful tool for the Bank's management and Board of Executive Directors. (See p. 19.)

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Although the Bank's program of audit has experienced problems, including getting off to a slow start, it is hoped that, with the recent appointment of a new U.S. member to the Group and close attention by the Department of the Treasury, the Group will develop into an effective evaluative mechanism.

RECOMMENDATIONS OR SUGGESTIONS

The Secretary of the Treasury should:

--Urge the Bank's Board of Executive Directors to expand the Group with additional senior staff having professional experience in management auditing or consulting and varied academic backgrounds.

--Impress upon the Group the continued need for clear and concise presentation of its findings and recommendations for corrective action. (See p. 20.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Department of the Treasury said that it agreed with the overall thrust of GAO's report and that it was in the process of implementing GAO's recommendations.

The Department added that, although the size and skills of the senior staff of the Group were now being expanded, the Bank's internal audit staff was planning to step up its review activity and that the degree to which this work should be duplicated or replaced by the Group needed further study. GAO believes that all internal audits and reviews should be taken into account by the Group when setting the scope of its own work. (See p. 11.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

Observations on the experiences and reports of the Inter-American Development Bank review group discussed in this report should be useful in any considerations concerning the establishment of similar review bodies for other major international organizations and institutions, H 1113 as was recommended in a GAO report to the Committee on Foreign Affairs, C 2 House of Representatives. (B-161470, December 4, 1970.)

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

PROGRESS MADE TOWARD INDEPENDENT AND COMPREHENSIVE AUDITS OF THE INTER-AMERICAN DEVELOPMENT BANK
Department of the Treasury B-161470

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The act was amended in 1967. Among other things, it directed the Secretary of the Treasury (the U.S. representative to the governing body of the Bank) to work toward independent and comprehensive audits of the Bank.

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--Urge the Bank's Board of Executive Directors to expand the Group with additional senior staff having professional experience in management auditing or consulting and varied academic backgrounds.

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MATTERS FOR CONSIDERATION BY THE CONGRESS

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CHAPTER 1

INTRODUCTION

The Inter-American Development Bank, which was established by international agreement in 1959, is an intergovernmental institution having 23 members consisting of the United States and 22 Latin American countries. It makes loans and provides technical assistance for economic development of its Latin American member countries.

The Bank's operations are managed by its President and a professional and administrative staff. Proposals for loans and technical assistance to member countries and routine policy considerations are subject to approval by the Board of Executive Directors which represents member governments. Major policy matters are considered and approved by the Board of Governors which also represents member governments.

U.S. membership in the Bank was authorized by the Inter-American Development Bank Act (Pub. L. 86-147), approved August 7, 1959. The United States signed the international agreement establishing the Bank on October 14, 1959. The Secretary of the Treasury has the primary responsibility for managing U.S. participation in the Bank. Also, he serves as the U.S. Governor on the Bank's Board of Governors. The Secretary is assisted in carrying out his responsibilities by the National Advisory Council on International Monetary and Financial Policies which evaluates proposed Bank loans and other actions and recommends decisions to the Secretary. This Council consists of the Secretary of the Treasury as Chairman, the Secretaries of State and Commerce, the President of the Export-Import Bank of the United States, and the Chairman of the Board of Governors of the Federal Reserve System.

From inception of the Bank through November 30, 1970, it had approved loans totaling $3.9 billion. The operations of the Bank are financed principally by financial contributions from members and borrowings on the open bond market. The United States has contributed 76 percent of all members' financial support of the Bank, as shown in the following table.

Financial Support as of December 31, 1970
(in millions of U.S. dollar equivalents)

Bank fund	United States Amount	United States Percent	All other members Amount	All other members Percent	Total amount
Ordinary capital	$ 150	39	$238	61	$ 388
Fund for Special Operations	1,800	77	528	23	2,328
Social Progress Trust Fund	525[a]	100	-	-	525
Total	$2,475	76	$766	24	$3,241

[a]Includes $18.8 million not yet paid to the Bank.

The above amounts do not include members' callable (by the Bank) subscriptions to the ordinary capital of the Bank, which amounts to $2.4 billion (U.S. share is $1 billion). Callable subscriptions act as a guarantee for the Bank's borrowings on the open bond market.

In 1967 the Inter-American Development Bank Act was amended by Public Law 90-88. This amendment, among other things, directed the Secretary of the Treasury to instruct the U.S. Executive Director of the Bank to propose the establishment by the Bank's Board of Executive Directors of a program of selective but continuing independent and comprehensive audit of the Bank, in accordance with such terms of reference as the Board of Executive Directors may prescribe.

The amendment directed also the Comptroller General to prepare for the Secretary of the Treasury a scope of audit and auditing and reporting standards for use by the U.S. Executive Director in assisting in the formulation of the terms of reference. It further directed the Comptroller General to review periodically the reports of audit and findings issued and to report to the Secretary of the Treasury and to the Congress suggestions for improving the scope of audit or auditing and reporting standards.

On January 24, 1968, the Comptroller General transmitted to the Secretary of the Treasury the required statement on the scope of audit and the auditing and reporting standards. This was the basis for a statement of basic guidance and standards on the establishment and operation of the audit program approved by the Bank's Board of Executive Directors on March 28, 1968.

The basic guidance provided that the work be carried out by a group having three principal members--one from the United States and two from the other member countries. The Group, called the Group of Controllers of the Review and Evaluation System, was installed on October 3, 1968.

In August 1969 the Group submitted its first report, entitled "Study of Sources and Uses of Funds," to the Bank's Board of Executive Directors. The Department of the Treasury forwarded the study to the Comptroller General in April of 1970.

The Group submitted its second report, entitled "Report on Loans to Venezuela," to the Board of Executive Directors in December 1969. The Board returned the report to the Group with instructions to improve its format. In July 1970 the Group resubmitted the second report. The Department of the Treasury forwarded the report to the Comptroller General in December 1970.[1]

In December 1970 we made a review of these two reports. Our review was directed toward determining whether the reports were responsive to the basic guidance and directives of the Bank's Board of Executive Directors and to the interests of the U.S. Congress upon whose initiative the program of audit was established. In our review we referred to the Bank's annual reports and to certain other documents

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[1] In commenting on a draft of our report, the Department of the Treasury advised us that there would be a normal delay of a few months in making the Group's reports available to us due to the procedures for review and approval of the reports by the Bank's Board of Executive Directors. The reports will be made available to us only after the Board has accepted the report, at which point it becomes formally available for distribution to member governments.

and had discussions with members of the Group and officials of the Department of the Treasury. We did not verify the accuracy of the data and the statements made in the reports.

At the time of our review, the Group had completed a review of the Bank's operations in Paraguay. After we had completed our review and made a draft of our report available for comment by the Department of the Treasury, the Department forwarded the Group's report on the Bank's operations in Paraguay to us. Although the Paraguay report was not included in the scope of this review, it appears, on the surface, to be significantly improved in format over the Group's first two reports. We intend to analyze this report at a future time in connection with our continuing evaluation of the Group's activities.

CHAPTER 2

PROGRESS TOWARD ACHIEVEMENT OF AN EFFECTIVE PROGRAM OF AUDIT

Progress has been made toward implementation of a program of audit of the Inter-American Development Bank, as evidenced by the establishment of the Group and the issuance of the Group's initial reports. To date, however, the Group's productivity has been limited, in part, because of its small staff.

The Group's first report undoubtedly had value as an internal working document for the Group, and its second report contained a great deal of useful information. Both reports, however, have deficiencies in either substance or format, which severely limit the reports' usefulness as effective management tools. Treasury Department and Bank officials are aware of these deficiencies and have indicated that they expect considerable improvement in future reports.

COMMENTS ON THE GROUP'S STAFF CAPACITY

The amendment to the Inter-American Development Bank Act, which directed the Secretary of the Treasury to instruct the U.S. Executive Director of the Bank to propose the establishment of the program of audit, was approved on September 22, 1967, and the Comptroller General's statement on audit scope and standards was transmitted to the Secretary of the Treasury on January 24, 1968. The Group was installed on October 3, 1968, after formulation and acceptance of the terms of reference for the program of audit and the recruitment and selection of the members of the Group.

At the time of our review, the Group consisted of its three principal members (Controllers)--one each from the United States, Argentina, and Ecuador--and four professional assistants. Each of the Controllers and assistants were economists.

Through the end of 1970, two reports prepared by the Group had been released to the Department of the Treasury and, in turn, to us. The Group's third report, which was not included in the scope of our review, was forwarded to us in February 1971. (See p. 8.) As discussed in the following section, the Group's first report, issued 10 months after the Group was installed, was not really an audit report but essentially was an internal working document for use of the Group itself. The Group's second report--its first substantive report--was issued in July 1970.

Some of the time spent in the earlier period was undoubtedly used in basic orientation and organization. Also, the work of the Group was somewhat hampered by the subsequent ill health and resignation of its original U.S. member in September 1969. His successor was not appointed until July 1970.

We understand that, at the time of our review, the Group was engaged in a single assignment, a functional review of loans made by the Bank in the education sector. We were informed by the Group that it had been able to work on essentially only one review at a time because of the size of the staff.

We were informed also that the Group had relied and intended to rely, in the future, on the staff of the Bank's management for the development of data used in the Group's reviews. In view of the need to maintain independence in the performance of the reviews, there should be extreme caution in the extensive use of this practice. Independently derived data is an essential element of the review process, to provide a basis for the Group's judgments and conclusions.

The above factors, we believe, indicate a need for greater staff capacity to enable the Group to direct a number of simultaneous reviews and thus achieve greater utilization of each Controller's own experience and skills during the 3-year period that each will serve as a member of the Group.

Moreover, to complement the Group's expertise (at the time of our review all of the Controllers and assistants were economists), it would be desirable to recruit persons from other academic disciplines and professional backgrounds. This would provide insight into the Bank's operations from various perspectives. The desirability of a variety of training was recognized and encouraged by the Board of Executive Directors in approving the regulations governing the operation of the audit program. These regulations state, in part, that:

> "the auditors shall be persons of recognized competence and wide experience in evaluating economic and financial matters. Their experience should include a minimum of ten years in auditing or in the discipline of law, economics or engineering with a background of auditing and/or the evaluation of economic development projects."

We believe that the U.S. Executive Director should urge the Bank to expand the Group with additional senior staff members having professional experience in management auditing or consulting and varied appropriate academic backgrounds.

In commenting on a draft of our report, the Department of the Treasury said that the size and skills of the senior staff of the Group were now being expanded. It added, however, that the Bank's internal audit staff was planning to step up its reviews to cover all activities in each country every 3 years and that the degree to which this work should be duplicated or replaced by the Group needed further study. We believe that all internal audits and reviews should be taken into account by the Group when setting the scope of its work.

COMMENTS ON THE GROUP'S FIRST REPORT--STUDY OF SOURCES AND USES OF FUNDS

The study does not represent an audit in the strict sense of the word. It is basically an accumulation of statistics and data from the Bank's annual financial reports. There appears to have been little or no independent evaluation of the data presented in the report. The report appears to be primarily an internal working document. The study was probably a necessary initial step by the Group members in orienting themselves and assembling basic working data which presumably would be useful to their later work. We were informed that the study was useful in identifying potential areas for future management reviews.

We would have no reason to comment on the use of the report as an internal working document, for which it appears to be best suited. As an external product of the Group, however, it fails in several ways to satisfy the requirements of the basic guidance and the auditing and reporting standards adopted by the Bank's Board of Executive Directors.

Inadequate scope

The basic guidance governing the work of the Group states, with respect to the scope of audit:

> "The audits are intended *** to be analytical examinations of all important operations, activities and procedures of the Bank with special consideration to the implementation and administration of the Bank's loans and technical assistance operations."

The study is not an analytical examination of operations, activities, and procedures of the Bank. The report shows the flow of funds through the Bank without in-depth interpretation of the data reflected. The little analysis included in the report is very superficial. It is more a narrative of financial events than an analysis. The study's shallow scope undoubtedly was a contributing factor to the report's failure to meet the required reporting standards--i.e., reporting unsupported conclusions--as noted in the following section.

Unsupported conclusions

The basic guidance and standards approved by the Board of Executive Directors, in regard to standards of reporting, states:

> "Matters included in the auditors' reports should be significant, and they should be clearly written, accurate, and fully supported by facts."

The report includes a number of statements under the heading "Summary and Comments" that do not appear to have been supported or substantiated by the work performed by the Group. We believe that it is appropriate, therefore, for us to comment on some of these statements.

For example, the report concluded that, on the basis of the Group's study, the Bank was in a sound financial position and that, on the strength of its own resources and its prestige as an international institution, the Bank had been able to raise funds by floating bond issues.

We believe that the report does not contain sufficient evidence to support its conclusion concerning the financial condition of the Bank. In commenting on a draft of our report, the Department of the Treasury agreed that the statements made in the Group's report on the institution's financial condition were not supported by the study itself. The Department of the Treasury added that the Bank had an independent financial audit made each year by a leading U.S. accounting firm and that the firm had made a comprehensive audit of the financial situation of the Bank. The Department of the Treasury asserted that there was no question about the absolute financial solvency of the Bank.

That the Bank is or is not in sound financial condition is, of course, not at issue. As recognized by the Treasury Department, the study simply does not support the report's conclusion that the Bank is in sound financial condition and therefore does not satisfy the basic guidance and standards approved by the Board of Executive Directors.

There is no question that the Bank has enlarged its own resources. We believe, however, that the Bank's large proportion of callable capital stock subscriptions, rather than its prestige as an international institution, probably has been the primary reason for its success in selling bond issues. Each of the Bank's recent annual reports has stated that the Bank has been able to sell bonds because its callable capital serves as a guarantee that the bondholders will be paid.

On a somewhat related matter, the report concluded that, except for one case, the Bank had no past due loans and thus permitted the multiple use of its funds.

Although we are not suggesting that past due loans have been a significant problem, by way of comment, we refer to note I of the Notes to the Financial Statements for Ordinary Capital Resources in the Bank's 1968 annual report, which stated that, in 1966, two borrowers, one in Brazil and one in Argentina, had defaulted on interest and principal payments on two loans each.

The Bank started foreclosure proceedings on the borrowers, both private enterprises, and obtained and sold the collateral of the Argentine borrower. The Bank realized $954,122, which was applied against the amount owed, and the balance of $1,845,149 was charged against the General Reserve for Ordinary Capital. Brazilian courts have upheld the Bank's rights to foreclose on the Brazilian borrower, and steps are being taken to sell the property seized, according to the annual report.

Thus, according to the note to the 1968 financial statements, the Bank has had not one but four past due loans to two separate borrowers. The charge of $1,845,149 against the General Reserve for Ordinary Capital in 1968 is shown as a Special Charge in a supporting schedule to the Group's report on the study.

The Department of the Treasury advised us that all of these defaults were known by the Group but that the Group's analysis had proceeded on the basis of the current position on open defaults and had focused on the identity of the borrower rather than on the number of loans to the borrower. It should be noted, however, that the Group's stated reason for using the flow-of-funds analysis was that traditional financial statements enabled analyses of only a static situation, whereas the purpose of its study was to disclose financial changes over a period of time. We believe, therefore, that it would have been more relevant to reveal the number and amount of loans defaulted and written off, as well as those not yet written off, rather than to disclose only the number of borrowers currently in a default status.

COMMENTS ON THE GROUP'S SECOND REPORT--
REPORT ON LOANS TO VENEZUELA

This report is a comprehensive, detailed study of all the Bank's loans to Venezuela, with description and analysis of their impact on the country's economy. The report represents an analytical examination and contains several excellent points but loses most of its potential usefulness because of its lack of organization and sheer size--190 pages of text and 91 pages of statistical appendixes. It does not meet the criteria of the basic guidance and standards approved by the Board of Executive Directors that "Audit findings and related conclusions and recommendations should be presented in an objective, concise, complete, and constructive manner" and that "All reports should clearly state the scope of the auditors' inquiry and nature and extent of their work."

Need for improved format

The first section, entitled "Remarks, Conclusions and Recommendations," is 56 pages long and consists chiefly of descriptive remarks. Few conclusions are identified as such, and few recommendations are made.

The report appears to be organized and written in terms of activities examined by the Group. We believe that the report would have been more useful to the Bank's management and Board of Executive Directors for whom it was intended if it had been organized and concisely written in terms of its findings and recommendations for corrective action.

No central theme or conclusion is presented. Issues, problems, and accomplishments are not highlighted or even identified except as can be gleaned from the text of the report. A statement of the scope of work done is lacking, although such statement is required by the basic guidance and standards, and the support for statements made in the report is not always evident. Thus it is difficult for a reader to judge the veracity and reliability of statements made.

In short the reader can form conclusions on the effectiveness of Bank loans only after carefully studying the report several times. The value of this type of report to busy managers and executives is limited because of the time required to extract its message.

Significant points made in the report

Notwithstanding the deficiencies in format and organization, the report does contain a number of good points and obviously is the product of a rather exhaustive analysis. Some of the more significant points are presented herein for the purpose of illustrating the kinds of information the Group is in a position to make available for consideration and action by the Bank's management and Board of Executive Directors.

Undisbursed loan balances

The Bank's 1969 annual report reveals that over 36 percent of the Bank's current loans to Venezuela is undisbursed. The Venezuela report concluded that the disbursement lag was due to inadequate project studies which caused delays in project execution. It recommended that:

1. Additional documentation be required in the loan documents, i.e., an assessment of the economic and social viability of the project, including an estimate showing the cost-benefit ratio.

2. The impact of the project on employment, wages, and project-related activities be determined.

3. The Bank exercise permanent control measures during project execution.

4. A policy be established for the Bank to govern subloans by the borrower to protect the Bank's investment by forestalling defaults and ensuring effective utilization of the Bank's funds.

Agrarian reform system not fully successful

The Bank has made two loans to Venezuela for a total of $12.7 million to finance farm settlements in its agrarian reform program. The report indicates that this program has not been completely successful in achieving its major objective of creating a genuine class of small farmers in Venezuela, although in terms of land settled, homes and schools built, and people moved, it could cite impressive statistical accomplishments. The report attributes the program's lack of success to the fact that all of the settlers' living needs are provided by the government and most of their farming work is done for them by government agencies.

Need for improved project reporting

The report indicated that, of the 14 Bank loans to Venezuela that were completely disbursed, four still lacked a final report from the borrower to the Bank and three had incomplete final reports. The report indicated also that quarterly reports were inadequate.

Furthermore the report noted that, although the Bank carefully reviewed progress reports because they involved pending disbursements, final reports were not being reviewed carefully because no further processing was required after the project was terminated.

The report stated that, in the case of three loans lacking final reports, the borrowers were awaiting a methodology and appropriate instructions from the Bank for preparing them.

Subloan defaults

The report indicated that all payments of principal and interest to the Bank had been made on time by Venezuelan borrowers, there being no loans in default or even in arrears. On the other hand several of the borrower agencies were experiencing defaults and delinquencies by industrial subborrowers.

Problems in housing sector loans

According to the report, problems were encountered in the construction of low-income housing projects under the supervision of an intermediate credit agency. The report noted that (1) much of the completed housing lacked basic services--such as water, electricity, and other community facilities--which resulted in nonoccupancy, (2) early construction was on the edge of the highways, in two long rows of houses, which resulted in higher costs of water supply and in a lack of community development, (3) repayments were very much in arrears, and (4) the intermediate credit agency, from an organizational point of view, had some serious flaws.

The report emphasized that the loans had been granted some years ago when the Bank still had not fully consolidated its technical-administrative organization and indicated that lessons learned from these early adverse experiences had been reflected in recent loans.

CONCLUSIONS, RECOMMENDATIONS, AND AGENCY ACTIONS

Although the Bank's program of audit has experienced problems, including getting off to a slow start, it is hoped that, with the recent appointment of a new U.S. member to the Group and close attention by the Department of the Treasury, the Group will develop into an effective evaluative mechanism.

After we completed our review of the Group's first two reports and made a draft of our report available for review by the Department of the Treasury, the Department forwarded to us the Group's third report which related to a review of the Bank's operations in Paraguay. We intend to analyze the report in connection with our continuing evaluation of the Group's activities. Also, the Group published a brief of the report, which appeared to be an excellent summary of the Group's findings and recommendations for corrective action. Also, we will need to analyze this brief in the light of the report itself, but, on cursory review, it appears to be a useful tool for the Bank's management and Board of Executive Directors.

On the basis of our review of the Group's first two reports, we recommend that the Secretary of the Treasury:

--Urge the Bank's Board of Executive Directors to expand the Group with additional senior staff having professional experience in management auditing or consulting and varied academic backgrounds.

--Impress upon the Group the continued need for clear and concise presentation of its findings and recommendations for correction action.

The Department of the Treasury said that it agreed with the overall thrust of our report and that it was in the process of implementing our recommendations. The Department said, however, that the report on Paraguay had a much improved format. We agree that the brief accompanying the report on Paraguay is a step in the right direction.

APPENDIXES

THE DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

April 26, 1971

Dear Mr. Stovall:

Thank you for the opportunity to comment on the draft GAO report, entitled "Progress Toward Implementation of a Program Audit of the Inter-American Development Bank."

I agree with the overall thrust of your report. In particular, I believe the conclusion section is a fair appraisal of the current status of the development of this innovative and constructive audit procedure, and we are in the process of implementing your recommendations. In our opinion, your report provides further encouragement to the Bank to move forward energetically in their present direction.

There are three parts of the report itself, on which I would like to provide comments and clarification. First, there will be a normal delay of a few months in making audit reports formally available to the GAO, due to the internal procedures for approval. Completed reports are submitted to the Bank's Board of Executive Directors for examination and review. In these initial reports, ample lead time was necessary for them to study the document before it was finally reviewed in the Board. It is only once the Board has examined and accepts the audit report that it becomes formally available for distribution to Governors. At that stage, the U. S. Governor formally transmits it to the GAO. This explains what might otherwise seem to be an unnecessarily long delay between completion of the unapproved report and subsequently Treasury's making it available to you.

Secondly, your report accurately states that the first study on sources and uses of funds was for internal use and orientation. It was not designed to be an analytical audit or financial report. From that viewpoint, it is true that several of the statements made in the Bank report on the institution's financial condition were not supported by the study itself.

[See GAO note, p. 24.]

As you are aware, the Bank has an independent, outside financial audit each year, carried out by a leading U. S. accounting firm, which makes a comprehensive audit of the financial situation of the Bank. There is no question about the absolute financial solvency of the institution.

[See GAO note.]

Your report has correctly identified shortcomings in the format of the second report. The third report on Paraguay, which is now in your possession, has a much improved format, so that it is now a useful management tool.

Lastly, your report recommends an expansion of the size and skills of the senior staff on the group. This is now taking place within limits; however, we would like to point out that we believe there are real limits to the rate of expansion. For example, the group must apply a uniform approach and criteria to each audit. As you are aware, the Bank has its own internal audit staff. In addition, the Bank staff conducts ex-post project evaluations of a general economic nature. A principal difference between these staff activities and those of the new group is that the former are reported directly to management, rather than to the Board. The internal audit group is now planning to step-up its reviews in order to cover all activities in each country every three years. The degree to which this work should be duplicated or replaced by the comprehensive audit group is an open question, which we will be discussing with you as the system evolves.

Very truly yours,

For John R. Petty

The Honorable
Oye V. Stovall
Director, International Division
United States General Accounting Office
Washington, D. C. 20548

Attachment

GAO note: Comment refers to material in the draft report but excluded from the final report.

OFFICIALS PRIMARILY RESPONSIBLE FOR ADMINISTRATION OF U.S. PARTICIPATION IN THE INTER-AMERICAN DEVELOPMENT BANK

	Appointed or Commissioned
SECRETARY OF THE TREASURY:	
John B. Connally	Feb. 1971
David M. Kennedy	Jan. 1969
Henry H. Fowler	Apr. 1965
ASSISTANT SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS:	
John R. Petty	May 1968
Winthrop Knowlton	Aug. 1966
U.S. REPRESENTATIVE TO THE BANK'S BOARD OF EXECUTIVE DIRECTORS:	
Henry J. Costanzo	Nov. 1969
Edward Clark	May 1968
W. True Davis, Jr.	Sept. 1966

U.S. GAO, Wash., D.C.