EL SALVADOR

Accountability for U.S. Military and Economic Aid
The Honorable George W. Crockett, Jr.
Chairman, Subcommittee on Western
Hemisphere Affairs
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

In response to your request, we reviewed the accountability and controls for U.S. military
and economic assistance to El Salvador. Our report discusses the accountability and controls
in place and the extent to which these can prevent misuse and diversion of U.S. assistance.
We will send copies of the report to appropriate congressional committees, the Secretaries for
Defense and State, and the Administrator of the Agency for International Development. We
will make copies available to other interested parties upon request.

This report was prepared under the direction of Joseph E. Kelley, Director, Security and
International Relations Issues, who may be reached on (202) 275-4128. Other major
contributors are listed in appendix IV.

Sincerely yours,

Frank C. Conahan
Assistant Comptroller General
Executive Summary

Purpose

The United States provided El Salvador with $3.5 billion of military and economic assistance in the 1980s. The Chairman, Subcommittee on Western Hemisphere Affairs, House Committee on Foreign Affairs, requested that GAO review the accountability, controls, and monitoring mechanisms for U.S. military and economic assistance to El Salvador. GAO’s objectives were to determine if U.S. aid has been subject to misuse and diversion and if internal controls were adequate.

Background

The U.S. Defense Security Assistance Agency administers military aid. The U.S. Military Group in El Salvador is responsible for day-to-day operations of the military assistance program, which in fiscal year 1990 was allocated $86 million.

The Agency for International Development (AID) has a mission in El Salvador that plans, monitors, and controls economic assistance projects and activities. In fiscal year 1990, $228.9 million was allocated for U.S. economic aid to El Salvador. Under terms of AID assistance agreements, El Salvador is required to set aside large amounts of local currencies to fund development activities associated with AID’s program.

Results in Brief

U.S. military aid to El Salvador has generally been used in accordance with conditions set forth in Foreign Military Sales agreements. However, U.S. aid could be vulnerable to misuse or diversion because of control weaknesses. The U.S. Military Group and the Salvadoran Armed Forces plan to take action to improve controls over assistance.

Despite staff limitations, AID is generally following established policies and procedures for managing and controlling appropriated economic assistance to El Salvador, but some misuse has occurred.

El Salvador’s local currencies, which are associated with the AID program, are vulnerable to misuse because Salvadoran agencies, which have weak financial management capability, control the funds, not AID. This is AID’s standard practice in any country when local currency is involved. AID’s policy on its level of accountability for these funds is unclear, and AID staff resources are insufficient to closely monitor all local currency uses.
Principal Findings

Military Aid

GAO did not find evidence that U.S. military aid had been diverted since it last reported on this issue in August 1989 in El Salvador: Transfers of Military Assistance Fuels (GAO/NSIAD-89-188). However, U.S. military personnel exercise limited oversight and rely heavily on Salvadoran controls to ensure accountability.

El Salvador’s system for controlling and accounting for military supplies and equipment is workable but antiquated. El Salvador has not emphasized management controls over logistics due to combat activities. Most records are handwritten, and two military installations that GAO visited lacked written policies and procedures. Taking physical inventory to reconcile records with actual equipment and supplies on hand is done infrequently. During warehouse spot checks, GAO found that the actual amount in inventory was not accurately reflected in Salvadoran military accountability records. Furthermore, El Salvador’s military lacks adequate storage space, and U.S.-funded items such as outboard motors, ammunition, and weapons were not adequately secured. This is critical because the items could be stolen, affected by weather conditions, sabotaged, or accidentally exploded.

Economic AID Projects

Because of internal control deficiencies in Salvadoran agencies that implement aid projects, AID has increased its audit activity and, within staffing constraints, emphasized project monitoring. Nevertheless, the AID mission is not, as required, identifying financial control weakness before substantial monies are disbursed. Yet AID Regional Inspector General audits have identified weaknesses in Salvadoran agencies’ accounting systems, management capabilities, inventory controls, and internal control procedures. The AID mission and Regional Inspector General do not believe that project funds are widely misused in El Salvador. However, the mission personnel described three cases of suspected misuse that had been referred for investigation to AID’s Regional Inspector General.

Local Currency

Local currencies are vulnerable to misuse because Salvadoran agencies managing these funds have serious financial control weaknesses. Further, AID has insufficient staff to account for all local currency use.
Executive Summary

Almost half of the AID Regional Inspector audits of Salvadoran agencies have identified significant accounting system problems.

AID's policy on local currency accountability is not clear. The AID Regional Inspector General has taken the position that the AID mission is accountable for end use of local currency funds. Because staff constraints inhibit AID mission monitoring of local currency funds, the AID mission is increasing the amount of local currency spent on general expenses of the Salvadoran government. AID’s policy requires less accountability for local currency used in this way. This action could make the funds more vulnerable to misuse.

Recommendations

GAO recommends that the Secretary of Defense, after coordination with the Department of State, direct the Defense Security Assistance Agency and the U.S. Military Group in El Salvador to work toward reaching an agreement with the Salvadoran Armed Forces on actions needed to improve internal controls. These actions can include:

- appointing independent high-level officials to the Salvadoran property accountability and Inspector General positions,
- performing periodic inventories of the Salvadoran Armed Forces’ property to ensure that accountability for its custody and use is maintained and to reconcile physical counts with records, and
- authorizing the U.S. Military Group to conduct periodic spot checks of selected U.S.-funded military items to provide reasonable assurance of accountability and control.

In addition, GAO recommends that the Administrator, Agency for International Development, take the following actions:

- Ensure that the AID mission (1) performs in-depth financial management assessments of Salvadoran organizations scheduled to implement new AID dollar-funded projects and (2) works with El Salvador to correct identified problems.
- Clarify AID’s local currency accountability guidance for El Salvador. The guidance should clearly state (1) what constitutes reasonable assurance that host government agencies have adequate financial systems to manage local currency funds and (2) what degree of AID oversight and monitoring is required.
The Department of Defense generally agreed with this report. Defense indicated that El Salvador’s military had appointed an Inspector General and a Property Accountability Officer, installed a computer network to assist in inventory control, and was working with U.S. trainers to bring its system more in line with the U.S. model. Defense also commented that authorization for on-demand U.S. spot checks of Salvadoran facilities and inventories and other control issues would be discussed with Salvadoran officials during periodic joint program management reviews to provide the needed additional emphasis on accountability and controls.

AID generally concurred with GAO’s overall findings. AID said it has expanded the use of pre-award surveys, is moving towards annual financial audits of all its programs in El Salvador to assess accountability and internal controls, and is providing technical assistance when audits indicate accountability deficiencies. With these actions, AID believes it is already implementing GAO’s recommendations regarding dollar-funded projects. GAO believes that these actions will improve accountability. However, in GAO’s opinion, the pre-award surveys do not assess the overall management capacity of the implementing institution in sufficient depth to determine if it has the capability to properly manage AID projects and adequately account for project funds. In-depth management assessments are more likely to identify deficiencies that need to be corrected before substantial funds are disbursed.

AID also indicated that it is preparing guidance which will (1) require its missions to perform audits and financial assessments of host government units that administer local currency accounts and (2) specify how these accounts should be monitored. AID agreed that it had not defined what constitutes reasonable assurance that host government agencies have adequate financial systems to manage local currency funds and indicated that its new guidance will better define what mission actions are needed to provide reasonable assurance. AID said it would also review its requirements to determine how they can be stated more clearly.

The Department of State commented that GAO’s recommendations and the measures already being implemented by AID and the U.S. Military Group would ensure the integrity of the U.S. assistance program.
Contents

Executive Summary 2

Chapter 1 8
Introduction
Objectives, Scope, and Methodology 8

Chapter 2 10
Better Controls Needed to Ensure Accountability of Military Assistance
Military Aid Program 10
Some Sales Made Without U.S. Approval 13
Limited U.S. Monitoring 15
Salvadoran Controls Over Security Assistance 17
Conclusions 22
Recommendations 22
Agency Comments 22

Chapter 3 24
Economic Aid Program Controls
AID's Program 24
AID Staffing 24
Cash Transfers 25
Concessional Food Sales 26
Food Donations 27
Project Assistance 27
Need to Better Identify Control Weaknesses 31
Conclusions 33
Recommendations 33
Agency Comments and Our Evaluation 33

Chapter 4 35
Local Currency Is Vulnerable to Misuse
Local Currency Program 35
AID Trust Fund 36
Private Sector Credit 36
Extraordinary Budget Support 36
Ordinary Budget Support 39
AID's Guidance Is Ambiguous 41
Conclusions 42
Recommendations 42
Agency Comments 42

Page 6 GAO/NSIAID-90-132 Accountability for Aid to El Salvador
Since 1980, the United States has provided $3.5 billion of economic and military aid to El Salvador to assist its government in an ongoing struggle against a leftist insurgency. U.S. policy towards El Salvador and the amounts and type of aid provided have been subjects of continuing controversy for the U.S. administration and the Congress.

U.S. aid programs for El Salvador serve three basic purposes: military aid, balance-of-payments support, and development or humanitarian assistance. Military assistance primarily consisted of major end items such as vehicles and aircraft prior to 1985. Since then, the majority of military assistance has funded consumable items such as ammunition, fuel, spare parts, and training. El Salvador receives almost all of its military equipment and supplies from the U.S. military aid program.

El Salvador is also highly dependent on U.S. economic aid. The United States funds cash transfers for balance-of-payments support, concessional food sales and donations, and projects affecting virtually all civilian sectors to restore infrastructure damaged by the war, provide social services, and attempt to reactivate El Salvador's economy.

Allegations of misuse and corruption have plagued the assistance programs and have been a continuing concern for the U.S. government. In August 1989, we reported\(^1\) that El Salvador had improperly transferred U.S.-funded fuel to third parties without U.S. consent in violation of assistance agreements. Regarding economic aid, there have been several instances of alleged or actual misuse. For example, in 1984, allegations surfaced that U.S. cash transfers had been diverted to U.S. bank accounts. Corruption in the previous Salvadoran administration was a major theme in political campaigns leading up to the presidential election won by Alfredo Cristiani, who took office in June 1989.

Objective, Scope, and Methodology

The Chairman, Subcommittee on Western Hemisphere Affairs, House Committee on Foreign Affairs, requested that we review the accountability for and controls over U.S. military and economic assistance to El Salvador. Our objectives were to determine (1) if any assistance had been subject to misuse and diversion and (2) what accountability and controls are in place.

Regarding military assistance, we performed work in Washington, D.C., at the Department of State, the Defense Security Assistance Agency, and

military supply commands, where we examined the amounts and types of aid provided to El Salvador since 1980. In El Salvador, we met with officials of the U.S. Military Group (MILGROUP). We examined their records and reports on Salvadoran accountability procedures and discussed the level of U.S. program oversight and knowledge of potential or actual diversion or misuse of assistance. We also met with Salvadoran Armed Forces officials at all levels. We visited the six Army brigades, two Air Force bases, and a Navy installation as well as five other central warehouse/logistical facilities throughout El Salvador. We reviewed El Salvador's policies and procedures for receipt, issuance, and delivery of military supplies and equipment and performed physical spot checks of warehouse inventories to verify the accuracy of the records and adequacy of controls. Because our review focused on accountability for U.S. assistance, we did not review El Salvador's controls over its own resources used for military salaries and other purposes.

Regarding economic assistance, we conducted work at the Department of State and the Agency for International Development (AID) in Washington, D.C. We reviewed AID audits, cable traffic, evaluations, and other reports on AID and Salvadoran oversight and control of funds and discussed accountability issues with program managers. In El Salvador, we met with government officials in the Planning and Finance Ministries, the Central Bank, and Salvadoran auditing agencies and with mayors and local officials, and reviewed their procedures for controlling aid funds. At the AID mission, we met with U.S. and Salvadoran staff responsible for monitoring and controlling assistance activities. We reviewed policy statements and program documents to evaluate controls in place for the various aid programs. In Honduras, we met with the AID Regional Inspector General and his staff regarding audits and investigations of aid programs in El Salvador and reviewed their work papers for selected audits.

We conducted our review from July to December 1989 and performed fieldwork in El Salvador during September and October 1989. Our work was conducted in accordance with generally accepted government auditing standards.
Better Controls Needed to Ensure Accountability of Military Assistance

In the 1980s, the United States provided El Salvador almost $1 billion in military aid. We did not find evidence that U.S. military aid to El Salvador had been diverted or misused since our August 1989 report on illegal fuel transfers. However, U.S. and Salvadoran controls are not sufficient to provide reasonable assurance of proper use. Defense Department officials in El Salvador do not closely monitor how the Salvadoran Armed Forces use and control U.S. aid. Salvadoran procedures to store, inventory, and control U.S.-funded supplies and equipment could be improved to reduce opportunities for diversion and misuse.

Military Aid Program

From 1980 to 1989, the U.S. government provided $958 million in military aid. Of this amount, $833 million (87 percent) was financed with Military Assistance Program (MAP) grants, and $107 million (11 percent) was financed with Foreign Military Sales loan credits. The remaining $18 million (2 percent) paid for training under the International Military Education and Training Program (IMET). Since 1986, almost all aid has been in the form of MAP grants. The Defense Security Assistance Agency administers U.S. military aid programs, and the MILGROUP in El Salvador manages in-country program operations.
Of the $85 million in military aid for fiscal year 1989, $64 million was paid for ammunition, fuel, medical supplies, aircraft and vehicle maintenance, and other items to sustain military operations. About $16 million was used to replace equipment lost in combat, fund construction, and provide training. The remaining $5 million was embargoed by U.S. legislation.¹

¹Section 539, Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1989 (the Harkin Amendment), requires that $5 million of the funds appropriated for military assistance for El Salvador not be expended until the President reports to Congress that El Salvador has substantially concluded all investigative action with respect to those responsible for the January 1981 deaths of two U.S. land reform consultants and has pursued all legal avenues to bring to trial and obtain a verdict on those who ordered and carried out the murders. This sanction also applied to military aid funds for fiscal years 1987 and 1988.
The Foreign Military Sales Program is administered under the authority of the Arms Export Control Act. The act requires that no defense article or service shall be sold or leased by the U.S. government unless the recipient country agrees

- to obtain consent of the President before transferring any defense article, service, or training to a third party or permit its use for purposes other than those furnished and
- to maintain the security of U.S.-supplied articles or services and provide substantially the same degree of security as would be provided by the United States.

The Defense Department indicated that El Salvador should provide adequate security to U.S.-funded military items but that the legal requirement to maintain security of U.S.-supplied articles or services refers to
the safeguarding of classified information and equipment. The Defense Department said that El Salvador had no classified articles when our review was conducted. We note that the statute does not distinguish between classified and nonclassified materials. Furthermore, the Department was not able to provide any legal support for its position that (1) the statute was not meant to apply to all U.S.-funded military aid, and (2) the host country need not agree to provide substantially the same security as would be provided by the United States for nonclassified U.S.-funded articles and services.

All Foreign Military Sales agreements signed by the United States and El Salvador require the State Department’s approval before El Salvador can transfer items to a third party. According to Salvadoran and State Department officials, El Salvador has not requested consent to transfer items.

MAP grants are authorized by the Foreign Assistance Act of 1961. Prior to fiscal year 1982, MAP grants funded defense articles and services under procedures different from those used for Foreign Military Sales. However, effective in 1982, section 503(a)(3) of the Foreign Assistance Act authorized the transfer of MAP funds to the Foreign Military Sales trust fund for merger with the recipient country’s trust fund deposits. MAP-financed purchases are made through the Foreign Military Sales Program and are conducted under procedures governed by the Arms Export Control Act.

Through the IMET program, the U.S. government spent about $17.6 million in the 1980s to train Salvadoran military officers at U.S. military installations in the United States and Panama. Under this program, the U.S. government pays for training costs, including transportation and a daily living allowance. Funds are controlled by the U.S. government, and training must be approved by the Defense Security Assistance Agency on a case-by-case basis.

Some Sales Made Without U.S. Approval

Our August 1989 report stated that the Salvadoran Air Force sold 61,107 gallons of MAP-funded fuel to the United States and to third parties, including an organization involved in resupplying the Nicaraguan Democratic Resistance. Our report expressed concern that (1) the third-party transfers had not been approved by the United States and therefore violated sales agreements between the U.S. and Salvadoran governments and (2) El Salvador was generating cash from sales of MAP-funded
better controls needed to ensure accountability of military assistance

fuel—a result that we believed was not intended by the Arms Export Control Act. Furthermore, use of the cash revenues was not subject to U.S. control or approval.

Concerned that the U.S. government lacked control of fuel sales revenues, the MILGROUP developed a memorandum of understanding detailing the requirement for U.S. approval of fuel sales and other third-party transfers. Furthermore, the Defense Security Assistance Agency established procedures to credit U.S. payments for MAP-funded fuel for future Foreign Military Sales to El Salvador.

We found, however, that the Defense Security Assistance Agency had been refunding proceeds from U.S. purchases of MAP-funded fuel to a Salvadoran account used for commercial purchases that are not reviewed or approved by the United States. Between June 1987 and September 1989, Salvadoran officials spent over $1.1 million of fuel sales proceeds to purchase items, including an automobile, camera equipment, and a $300,000 building that MILGROUP officials believed may have been overvalued. For all purchases from the account, the United States transferred funds to El Salvador's military attaché in Washington, D.C., upon receipt of a request for payment.

The Financial Management Division of the Defense Security Assistance Agency indicated that it was unaware that the Department of Defense had planned to ensure that proceeds from MAP-financed fuel sales would be used only for Foreign Military Sales purchases and would not be made available to El Salvador for commercial purchases. On December 4, 1989, the Defense Security Assistance Agency directed its accounting center to discontinue refunding the proceeds from MAP-funded fuel sales to an account controlled by the Salvadoran government.

According to agency officials, fuel proceeds are now deposited in a Foreign Military Sales trust fund account. This is to ensure that the agency and the MILGROUP in El Salvador have an opportunity to review and approve all purchases financed with these funds. In addition, the Defense Security Assistance Agency indicated that it (1) has notified all security assistance offices worldwide that recipient countries must use proceeds from sales of MAP-funded fuel only to finance purchases under the Foreign Military Sales Program and (2) has modified the Security Assistance Manual to provide guidance concerning the proceeds from the resale of items purchased with U.S. financing.
Limited U.S. Monitoring

The U.S. government conducts limited monitoring of El Salvador's uses of U.S.-funded defense items. Defense Department procedures require security assistance organizations such as the MILGROUP in El Salvador to 

"observe and report on the utilization by the host country of defense articles, defense services, and training of U.S. origin. This function should be carried out as a secondary duty. How and to what extent such observation and reporting should and can be done will vary considerably from country to country and thus no standard procedures are described..."

MILGROUP officials told us that in the absence of more specific guidance, each member of the MILGROUP individually decides how much emphasis should be placed on monitoring responsibilities. The MILGROUP works with EL Salvador's military to determine what items should be provided, oversees aid shipments, and monitors some usage. According to the MILGROUP, its trainers are stationed at all the major military installations in El Salvador (brigades, air bases, and central warehouse operations) and are therefore generally aware of how U.S. assistance is being used.

However, we found that the MILGROUP does not extensively monitor the Salvadorans' use of U.S. military assistance. Because of staffing and time constraints, the MILGROUP does not closely review consumption rates of consumable items and does not conduct frequent inventories and spot checks of Salvadoran warehouses. As a result, the MILGROUP must rely heavily on the effectiveness and integrity of Salvadoran controls to ensure accountability.

MILGROUP officials also told us that, in general, they have not established tight controls because, in their opinion, almost all assistance is in the form of equipment and supplies, much of which has no nonmilitary uses. For example, the aid includes repair parts for military aircraft and weapons and ammunition that are not sold commercially in El Salvador. Moreover, military equipment and supplies are in short supply. According to the U.S. military officials, El Salvador's military needs exceed U.S. aid levels. For example, the MILGROUP estimated that El Salvador had needed over $100 million in 1989 for military supplies and equipment just to sustain operations, but the United States allocated $85 million. MILGROUP officials told us that because military supplies and equipment are in short supply, El Salvador's military is careful to conserve what it receives. To illustrate that supplies were in short supply, MILGROUP officials showed us that used syringes were being cleaned for reuse rather than thrown away at a military hospital we visited.
However, our review of MILGROUP activities and Salvadoran policies and procedures as well as our inventory spot checks indicated weaknesses in the controls over U.S. military assistance.

**Checks on Consumption and Inventories**

From May 1987 to April 1989, the MILGROUP conducted analyses on consumption data on ammunition, fuel, communication spare parts, batteries, medical supplies, and repair parts for helicopters, vehicles, and weapons. At the time of our fieldwork, the MILGROUP had discontinued some of these analyses and had limited its review to the use of fuel and ammunition, which it viewed as the most critical items. Time and staff constraints were given as reasons why more analyses of usage rates were not being performed. The MILGROUP has only one officer to analyze the data. Furthermore, according to the MILGROUP, there had been no indications of diversion or misuse.

Consumption data on various materials can be analyzed to find indications of fraud, waste, and abuses. Without such analyses, however, it is difficult to tell when assistance is being used for unnecessary purposes.

Periodic inventories and frequent spot checks of U.S.-funded supplies and equipment can, in our opinion, help account for U.S. military aid. The MILGROUP has not conducted inventories or spot checks on a regular basis. The MILGROUP Commander agreed that more frequent inventories and spot checks could help El Salvador's military to better control and account for U.S.-funded supplies and equipment. In early 1989, U.S. logistics trainers visited Salvadoran army brigades to observe logistics operations at these units. The trainers discussed logistics issues and needs with Salvadoran officers and conducted some spot checks of U.S. military aid. A U.S. logistics trainer in El Salvador told us that a periodic spot check program would not impose an unreasonable burden on U.S. military personnel.

Periodic spot checks of selected items by U.S. personnel ensure that appropriate accountability procedures are in place to prevent pilferage, loss, or misuse of aid. MILGROUP staff told us that these checks could be performed without significantly detracting from their other responsibilities. At the end of our fieldwork, the MILGROUP Commander indicated that he would work with the Armed Forces to implement these actions.

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2Defense Department procedures implementing the Foreign Assistance Act require annual inventories of MAP-funded equipment provided before 1982. In August 1989, the Inspector General from the U.S. Southern Command in Panama reported that these inventories had not been done.
Staffing and Travel Restrictions

According to MILGROUP officials, staffing and travel restrictions limit the extent to which U.S. personnel can monitor the use of military aid in El Salvador. For example, they said that they could not meet each arrival of U.S. military aid or monitor daily use of fuel. In addition to staffing constraints, U.S. military personnel are restricted from visiting combat areas. As a result, they cannot observe the use of all military aid.

Salvadoran Controls Over Security Assistance

Control weaknesses within El Salvador's Armed Forces could provide opportunities for diversion and misuse. These weaknesses include inventory discrepancies, lack of written procedures, limited storage space, and inadequate security provided for ammunition. Salvadoran officers acknowledged that management control over logistics was not emphasized in the past, but they believe that recent and planned actions will improve accountability and control practices. Salvadoran military officials appeared committed to correcting existing deficiencies.

Logistics Management Has Been Low Priority

According to Salvadoran military officials, combat activities have been the highest priority because of wartime conditions, and management control over logistics has been a low priority. As a result, El Salvador's military logistics system has not advanced to accommodate an expanded military and the U.S. military assistance program.

The Salvadoran Armed Forces grew from about 12,000 in 1980 to approximately 57,000 in 1989. Because logistics has not been emphasized, Salvadoran forces have received limited logistics training, and the number and quality of logistics personnel have not increased with troop growth. As a result of the shortage of experienced and trained logistics personnel, El Salvador's military relies on an antiquated logistical system to manage large quantities of materials.

Low emphasis on logistics has been cited in previous years' U.S. assessments of El Salvador's military capabilities. In 1984, a U.S. Army assessment team noted that lack of adequate logistics training would result in misdirected priorities. In 1985, a U.S. logistics team reported a lack of logistics emphasis, knowledge, and experience among Salvadoran officers. The report recommended that the Armed Forces increase all commanders' knowledge and awareness of logistics and develop a logistics officer corps.

El Salvador's military logistics system is primarily supported by a manual paperwork process. Most of the military units we visited were...
using ledger books, card systems, and schedules to record receipt, issuance, and on-hand balances. There was no standardized and systematic method for keeping records among the units, and our spot checks indicated some conflicting information in records. Salvadoran officers told us that data discrepancies often occurred because not all written records were updated simultaneously for each transaction. These manual systems do not permit easy tracking of receipt, issuance, and use of respective items.

The Defense Security Assistance Agency indicated that in February 1990, the Salvadoran military established a computer network for the Air Force to assist with accountability and control of all major end items and repair parts. This network is being expanded to encompass the entire Salvadoran Armed Forces.

During our fieldwork, we attempted to determine the location of a random sample of 150 M-16 rifles and 150 M-9 pistols delivered to El Salvador over the last 10 years. We provided a list of serial numbers for these weapons to the officials at the Salvadoran Armed Forces logistics headquarters and requested data showing the location of each weapon. The officials explained that extracting this data from the system would be difficult, but they subsequently provided us a list of the specific rifles and pistols from our samples that, according to Salvadoran records, were located at one of the brigades we were to visit. When we visited this brigade, we were shown other lists detailing weapons assigned to the brigade, but none of the rifles and pistols in our sample were on the lists. We subsequently located most of the pistols by accident during a visit to a central warehouse in San Salvador. Because of time constraints, we were unable to determine where the sample rifles and some of the pistols were actually located. These tests of military records do not indicate that the weapons in our sample had been diverted. The tests do indicate, however, that the military's central inventory records were incorrect and that an internal control problem exists.

According to the Vice Chief of Staff, El Salvador's military has made efforts to improve the quality of its logistics personnel and needs to emphasize training in order to correct these problems. Officials told us that they are concerned about logistics and believe they could do more but that they have been unable to concentrate on this area due to the focus on combat. The Vice Chief of Staff indicated that more capable officers will be placed in logistics positions as the conflict subsides.
Chapter 2
Better Controls Needed to Ensure Accountability of Military Assistance

In the last 2 years, the United States has increased emphasis on Salvadoran logistics training. For example, 61 officers attended U.S. facilities for training in inventory, supply, and other logistics fields. Furthermore, U.S. military trainers have provided other logistics training in automotive maintenance and repair, material security, and supply management.

According to the MILGROUP Commander, in addition to training, the appointment of a high-ranking official, such as the Vice Chief of Staff or the Chief of Logistics, to monitor the property accountability control program would improve accountability for U.S. military aid and help to limit potential for diversion or misuse of material. In addition, an active Inspector General operation could investigate fraud and abuse and also review and report on weaknesses in accountability and internal control policies and procedures.

According to a Ministry of Defense official, the Inspector General should be responsible for oversight of military accountability and use of material. The Inspector General position at the Ministry of Defense had not been filled since 1980 because of personnel and resource shortages. Since the position was vacant, the Armed Forces was enforcing its own accountability and control of military assistance. As a result, there was a potential conflict of interest that could affect the Salvadorans' ability to provide adequate assurances that U.S. military assistance is being used properly.

The Defense Security Assistance Agency indicated that since we completed our fieldwork, a Salvadoran colonel has been assigned primary responsibility to ensure that material and equipment are adequately accounted for and controlled. The agency also indicated that there is now a clear chain of command for the Salvadoran logistics system, which was not the case in the past. A Salvadoran military Inspector General, who will investigate allegations of irregularities in logistics matters, has also been appointed.

Evolving Written Procedures

El Salvador's military headquarters has established overall logistics policies and procedures. Each military unit is required to develop its own standard operating procedures based on this guidance. Headquarters directives include procedures for reporting receipt and distribution, conducting inventories, and accounting for military property. All military units are required to submit periodic reports to headquarters about material received, issued, consumed, on hand, and missing or lost.
According to Salvadoran directives, commanders at headquarters, central warehouses, brigades, units, and individual soldiers are held accountable for assigned items and are required to pay for losses due to negligence. For example, a soldier at the Second Brigade lost 15 compasses, and their cost was deducted from his salary. Furthermore, the Armed Forces Chief of Logistics told us that to ensure accountability of arriving shipments of military aid, the Chief and/or several other staff meet most shipments so that the shipments can be entered into the property accountability system as received.

Written logistics operating procedures, however, were not in place at all military units. Of the 14 units we visited, one Army brigade and one Air Force base did not have written procedures. Although this is not a wide-scale weakness, it does provide opportunities for mistakes and misuse, especially when responsible logistics personnel are absent.

Salvadoran officials are attempting to improve controls by updating and coordinating key guidance documents. The Vice Chief of Staff is heading a committee to update army regulations to better describe accountability responsibilities and has requested assistance in preparing these regulations.

Inadequate Storage Space

Military aid agreements require El Salvador to provide the same degree of security to U.S.-funded defense items as would be provided by the United States. Of the 14 military units we visited, 7 had limited storage space. As a result, some U.S.-funded supplies and equipment were inadequately secured. For example, at a naval installation, 13 outboard motors were stored outside due to lack of space within the warehouse. According to MILGROUP officials, inadequate secured storage space is a problem at many installations—a problem exacerbated by damage caused during the 1986 earthquake. In addition, disposal of unusable material has been delayed by bureaucratic problems, such as long waiting periods for the EL Salvador Court of Accounts to examine and designate items as totally unusable and approve disposal, thereby leaving less storage space for new supplies.

MILGROUP staff were particularly concerned that some U.S.-funded ammunition was not properly secured at four military units. The lack of adequate storage space for ammunition is critical because it could be stolen, affected by weather conditions, sabotaged, or accidentally exploded. For example, we saw ammunition being stored in a 20-year-old condemned building that had been damaged by the 1986 El Salvador earthquake.
earthquake. At one brigade, 59,000 rounds of small arms ammunition and 132 grenades were stored in an unguarded building with multiple access points, and at one Air Force base, ammunition, bombs, and missiles were stored in an open hangar. In commenting on a draft of this report, the Defense Security Assistance Agency indicated that the Salvadoran Armed Forces are continually constructing and upgrading facilities to store and secure materials and that U.S.-funded projects were in process to improve physical security at two locations where we had noted security deficiencies.

### Inventory Discrepancies

According to Salvadoran officers, comprehensive inventories have been performed about every 3 years, when there has been a change in the commander or logistics officer. When inventories have been conducted, there have been significant differences between amounts on hand and amounts recorded in inventory records. For example, Salvadoran and U.S. military personnel inventoried automotive and weapons repair parts at a military warehouse in September 1989. Of the 1,944 types of items counted, 984, or over half, did not match inventory records. For 509 of the 984 discrepancies, the warehouse had fewer items than the records reflected, and in 475 cases it had more. The Armed Forces had asked the MILGROUP for help in conducting the inventory because it did not know what it actually had on hand.

During our fieldwork, we conducted 86 spot checks, or physical counts, of material at 14 military units (six Army brigades, two Air Force bases, a Navy base, a military training base, and four central warehouses). The items checked included aircraft, patrol boats, automotive repair parts, weapons, ammunition, explosives, binoculars, flashlights, ball bearings, tires, and blankets. In most cases, some inventory records were available. In 25 cases inventory records and our physical counts differed. Of the 25 discrepancies, 11 indicated items in excess of the number shown on the records. For example, at one Army brigade the records indicated that 1,072 90-millimeter cartridges were in stock, yet our physical count was 1,903. In 14 cases, our spot checks indicated that the number of items was less than the number recorded. For example, records at one brigade indicated that 470 flares were in stock, but we actually found 417.

Periodic inventories of property can help verify the accuracy of accountability procedures. Inventory teams could randomly check selected items on a quarterly basis at specified units. The MILGROUP Commander stated that the results should be reviewed to ensure that
accountability procedures are effective. If these procedures were found not to be in effect, an investigation should be initiated by the Salvadoran Chief of Staff, the Property Accountability Officer, or the Salvadoran military Inspector General.

Conclusions

We did not find evidence of any recent diversion or misuse of military assistance, but U.S. aid could be vulnerable to misuse or diversion because of control weaknesses. For example, some written procedures are lacking, storage space is inadequate, and inventories and spot checks are not regularly performed. The MILGROUP and the Salvadoran Armed Forces plan to take action to improve controls over assistance.

Recommendations

We recommend that the Secretary of Defense, after coordination with the Department of State, direct the Defense Security Assistance Agency and the MILGROUP in El Salvador to work toward reaching an agreement with El Salvador's military on actions needed to improve internal controls. These actions could include:

- appointing independent high-level officials to the Salvadoran property accountability and Inspector General positions,
- performing periodic inventories of Salvadoran Armed Forces property to ensure that accountability for their custody and use is maintained and to reconcile physical counts with records, and
- authorizing the MILGROUP to conduct periodic spot checks of selected U.S.-funded military items to provide reasonable assurance of accountability and control.

Agency Comments

The Department of Defense generally concurred with our draft report. The Department indicated that actions have already been or would be initiated on our recommendations to improve controls and accountability.

The Department reported that the Salvadoran Armed Forces had appointed an Inspector General and assigned to a high-level logistics officer the primary responsibility for accountability and control for materials and equipment. In addition, El Salvador's military has installed a computer network to assist in inventory control and was working with U.S. trainers to make its system more in line with the U.S. model through construction of physical security improvements, logistics training, and inventories to reconcile records with amounts on hand.
According to the Department of Defense, a bilateral agreement regarding the provision of U.S.-funded military articles and services to El Salvador provides U.S. military personnel adequate access to Salvadoran military facilities to observe and review Salvadoran security and use of U.S. military aid. Furthermore, Defense commented that it meets semiannually with Salvadoran military representatives to review program progress and agree on necessary program improvements. Defense indicated that it would discuss this bilateral agreement, the U.S. desire for access to Salvadoran facilities to perform inventory spot checks and other accountability and control issues with El Salvador's military during these semiannual program management reviews. Defense believed that this mechanism would give the needed additional emphasis to accountability and control issues.
The Agency for International Development (AID) uses established policies and procedures to control direct assistance funds in El Salvador. AID and the government of El Salvador have developed adequate systems to account for balance-of-payments aid, and AID monitors implementation, verifies expenses, and audits item end use for its projects and other activities. AID believes that these actions protect U.S. funds against misuse and diversion. However, AID auditors have found that some costs have not been properly documented, and they are investigating two projects for possible misuse of funds. El Salvador’s capacity to manage and control funds is generally weak. Accountability for AID’s large annual program budget, averaging $258 million since 1980, has depended on a relatively small number of staff in El Salvador to identify and correct control problems quickly. More attention to identifying potential control problems when designing new projects would reduce the likelihood that U.S. funds could be misused or diverted.

**AID’s Program**

The U.S. economic aid program for El Salvador is the largest in the western hemisphere and the fourth largest in the world. AID provides cash grants for balance-of-payments support, administers U.S. concessional food sales and donations, and funds projects affecting virtually all civilian sectors. Between 1980 and 1989 U.S. economic assistance to El Salvador totaled nearly $2.6 billion. Table 3.1 shows economic assistance levels for the last 10 years.

<table>
<thead>
<tr>
<th>Type of aid</th>
<th>Fiscal years</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash transfers</td>
<td>$712.0</td>
<td>$161.0</td>
</tr>
<tr>
<td>Food sales (loans)</td>
<td>232.1</td>
<td>38.0</td>
</tr>
<tr>
<td>Food donations</td>
<td>37.6</td>
<td>10.9</td>
</tr>
<tr>
<td>Projects</td>
<td>509.8</td>
<td>159.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,571.5</strong></td>
<td><strong>$369.6</strong></td>
</tr>
</tbody>
</table>

Note: Figures represent obligated funds.

Source: U.S. AID mission, El Salvador

**AID Staffing**

In August 1989, the AID mission in El Salvador had positions for 39 U.S. direct hire employees who were to be responsible for program oversight. AID officials told us that, considering program size, staff levels in El Salvador were low compared to other AID missions. For example, the AID...
mission in Guatemala had 33 U.S. direct hire positions to manage its 1989 program budget of $143 million, which is less than half the size of the El Salvador program budget. The AID mission in Peru had 22 U.S. direct hires to manage its 1989 program budget of $39 million, which is only 13 percent of the size of El Salvador's program budget. In addition, AID has had difficulty filling its U.S. direct hire positions in El Salvador. For example, in August 1989, it had seven vacant positions.

In June 1989, the mission indicated that it needed six more U.S. direct hire staff to manage its program properly. During our fieldwork, the Ambassador said he was reluctant to approve additional permanent staff because of security and other considerations. After our fieldwork was completed, AID headquarters officials also stated that the mission would probably not get additional staff. The subsequent escalation of violence in El Salvador in late 1989 and the temporary removal of many AID staff indicate that the staffing issue will continue to be a problem for the mission. AID headquarters officials acknowledged that staffing at the El Salvador mission was low and that filling positions of staff departing in 1990 would be difficult. The AID mission has urged its headquarters to strengthen recruiting efforts to minimize future vacancies.

Even though the mission has a relatively low number of staff to manage its program, the mission believes it has been able to fulfill required monitoring and control responsibilities, in part, because much of the program involves cash transfers and concessional food sales, which do not require intense AID oversight to track disposition of the dollars and food. However, mission management believes that an excessive work load and concern about security could eventually cause staff burnout and reduce productivity.

Cash Transfers

Between 1980 and 1989, the United States provided $1.5 billion in Economic Support Funds to El Salvador. In 1989, the level of Economic Support Funds was $206.6 million. Of this, $157 million was for cash transfers to improve El Salvador's balance-of-payments position, and the remaining $49.6 million was obligated to specific projects.

For the balance-of-payments program, the United States deposits dollars into Salvadoran government accounts at four U.S. commercial banks. El Salvador's Central Bank then draws from these funds to support the sale of dollars to importers. In exchange, Salvadoran importers provide the Central Bank with local currencies, which are used for developmental purposes, as discussed in chapter 4.
AID requires that cash transfer funds be used for imports that come from the United States and other approved countries and that they be used to sustain industrial and agricultural production. The Salvadoran government must identify the importer, cost, purpose, and origin of the imported goods or services. To ensure that the imports meet the above criteria, AID periodically reviews the eligibility of purchased imports and verifies that the prices paid were reasonable. AID explained that the last detailed eligibility review was completed in May 1988 but that AID had just begun to review the eligibility of imports since that time.

Between detailed AID eligibility reviews, El Salvador’s Central Bank provides monthly listings of imports financed by the balance-of-payments program. We reviewed 32 transactions from the Central Bank’s consolidated list of 4,784 transactions made from September 1987 to August 1989. These transactions were financed by a balance-of-payment cash grant of $159 million. The list contained all the information AID required for each transaction we reviewed, including dollar and local currency value, product type, name of exporter, exporter country, payment dates, and importer.

AID and the Central Bank have adequate systems to monitor the cash transfer program. In 1983, the Central Bank set up a price-checking unit to verify that imports meet program guidelines and are properly priced. During our prior review of the mechanisms for controlling cash transfer funds, we found that adequate controls were in place. In a 1989 report, the AID Regional Inspector General noted some minor program deficiencies but found no significant ineligible transactions based on tests of imports financed and did not identify any internal control weaknesses.

Concessional Food Sales

Between 1980 and 1989, the Public Law 480 Title I program has provided $345.6 million in low-interest, long-term loans to El Salvador to purchase food from the United States. During fiscal year 1989, the program provided food worth $40 million. Through the program, the United States sells food on concessional terms to the Salvadoran government, which resells the food through commercial channels. Sales proceeds are to be used for local currency activities, as discussed in chapter 4. The program helps to meet El Salvador’s food needs and also reduces the

balance-of-payments deficit by funding purchases that, without concessional financing, would have to be purchased with other sources of foreign exchange.

The Salvadoran government, through food sales agreements with Salvadoran commercial banks, exercises control over food sales and financial accounting of sales proceeds. Based on our review of Salvadoran government and commercial bank reports, we determined that the system to control the delivery and sale of food commodities is adequate. AID receives reports from the Central Bank on the arrival and sale of the food and verifies that the sales proceeds are deposited in designated accounts on a timely basis.

### Food Donations

Between 1980 and 1989, the Public Law 480 Title II program provided $74.7 million worth of food to El Salvador. Through the program, the United States donates food for distribution to the poor. In 1989, donated food worth $5.4 million was managed and distributed by El Salvador’s National Commission for Area Restoration (CONARA) and Catholic Relief Services, a U.S. private voluntary organization.

Although small compared to other AID activities, the food donation program has received extensive media attention. The media have alleged that food managed by CONARA had been illegally sold. AID officials stated that these allegations were exaggerated and that although there may have been some minor diversion of food, it was not a serious problem in El Salvador. AID closely monitors the activities of the food donation program by using a local firm to observe the arrival, inventory, and distribution of the food. We tested the inventory control process at a food warehouse and found no problems with the system. We reviewed the inventory cards and warehouse receipts for dry milk and cooking oil. The warehouse receipts agreed with the inventory control card entries and the quantity of dry milk on hand agreed with the inventory control card balance. We also observed food distribution activities at one location and found that the receipt and usage documents, required by CONARA directives, were on hand.

### Project Assistance

Between 1980 and 1989, the United States provided $972.0 million in project assistance to El Salvador. AID designs, plans, implements, and closely monitors projects based on mission-identified problems. In 1989, project assistance totaled $111.9 million—$49.6 million from Economic Support Funds and $62.3 million from Development Assistance funds.
These funds supported nearly 70 Salvadoran government and private agencies. Through these projects, AID restores sabotaged public services, rebuilds the infrastructure, helps displaced persons, provides loans and small business incentives, and provides education and social services vital to El Salvador.

El Salvador's government staff and private sector organizations lack financial management capabilities and, according to AID, have serious internal control weaknesses. Because of this situation, extensive monitoring by AID staff is required to ensure that project goals are met and that the funds are being spent as intended. The AID mission and the Regional Inspector General do not believe that project funds are widely misused in El Salvador. However, the mission personnel did describe three cases in which misuse may have occurred. In each case, the AID mission asked the Regional Inspector General to audit the programs as soon as irregularities were identified.

One case involved a Salvadoran private voluntary organization that had received about $4 million of AID funds for distributing food and medicine to displaced families. In December 1987, employees of the organization notified the mission of accounting irregularities, and 3 months later, the mission discontinued funding. In a January 1989 audit, the Regional Inspector General questioned $2.2 million in costs because of insufficient documentation and disallowable costs and referred additional findings of possible fraud to its investigative branch for further review. In September 1989, the mission director told us that the organization was no longer in business and that the questioned costs may never be recovered.

Another case involved a U.S.-based private voluntary organization that had a $6.9 million grant from AID for resettling Salvadorans displaced by the war and helping them to become self-sufficient. An AID audit questioned $200,000 of project costs, and in June 1989, the Regional Inspector General directed the mission to discontinue funding the organization's activities in El Salvador. As of July 2, 1990, this case was still under investigation.

The third case involved the Ministry of Health section responsible for purchasing and distributing medicines and medical equipment. An AID-contracted program monitor notified the mission that vehicle spare parts were being stolen from a warehouse. Because of this information, the organization and the mission replaced all warehouse guards, hired a
Chapter 3  
Economic Aid Program Controls

local firm to inventory the spare parts, and asked the Inspector General to audit the organization.

<table>
<thead>
<tr>
<th>Mission Attempts to Limit Misuse</th>
</tr>
</thead>
<tbody>
<tr>
<td>According to AID, the mission has made a concerted effort over the last 2 years to address problems of misuse. To accomplish this, AID uses a variety of controls to reduce the vulnerability of project funds. For example, the mission has increased its monitoring, particularly on projects with local private voluntary organizations. According to AID, the organizations often have accounting and financial control systems that do not meet U.S. government and AID standards. The mission has used AID auditors and local accounting firms to identify financial control and management weaknesses in agencies responsible for administering its programs. The mission has also implemented technical assistance projects and established semiautonomous management units in some agencies to insulate project funds from the agencies' weak internal controls. Finally, the mission has occasionally used banks to help certify vouchers submitted to AID for payment.</td>
</tr>
</tbody>
</table>

In an effort to address El Salvador's long-term financial management capabilities, AID began a $11 million project in fiscal year 1988 to provide technical assistance to the Court of Accounts (the government of El Salvador's supreme audit agency) and other government agencies. Although the financial management weaknesses in El Salvador will take years to correct, the mission believes this approach is the best way to limit the risk of misuse and diversion.

<table>
<thead>
<tr>
<th>Project Monitoring and Expense Validating</th>
</tr>
</thead>
<tbody>
<tr>
<td>AID and the mission have established policies and procedures to validate expenses and monitor projects. These procedures detail the accounting, reporting, and monitoring requirements both AID staff and the implementing agencies must perform. Our review showed that the mission has generally complied with requirements outlined in agency and mission regulations.</td>
</tr>
</tbody>
</table>

To determine AID mission's compliance with AID payment voucher processing guidance, we examined 15 vouchers from two projects. These vouchers accounted for $1.8 million of the $18.0 million in fiscal year 1989 expenditures for these projects. Each voucher we examined had been approved and reviewed in accordance with AID and mission criteria. For example, the Controller's office had checked each voucher for mathematical accuracy, attached all required documentation, and ensured that each voucher was approved and certified by the project.
officer. The implementing agencies had adequate support for the expenditures as well. We visited two agencies receiving project assistance funds to validate expenses claimed on the vouchers we had reviewed at AID. In both cases, the organizations had maintained original documentation to support these expenditures and had followed their accounting policies and procedures.

Established monitoring requirements enable AID to ensure that intended benefits of the project are being realized and that AID personnel are keeping abreast of project activities. AID said that it has used project monitoring as one tool to prevent misuse and diversion of U.S. assistance and has augmented its U.S. direct hire staff with 203 foreign national, third country, and contract employees to ensure monitoring responsibilities are met. We found that AID staff were fulfilling monitoring responsibilities by helping implementing agencies overcome management weaknesses and conducting site visits—often to war zone areas. We accompanied AID staff on project visits and observed that they knew what progress should have been made since their last site visit and that they determined the causes for delays or other problems. Additionally, we visited an inventory and maintenance management unit established by AID at the Ministry of Public Works. This unit was following established control policies and procedures.

AID Regional Inspector Audits

In auditing assistance projects during fiscal year 1989, AID's Regional Inspector General identified numerous internal control weaknesses in both Salvadoran government and private organizations receiving AID funds.

For example, an audit of one part of an earthquake recovery project found that the Salvadoran implementing agencies lacked adequate supervision over the accounting process, had inadequate payroll payment procedures, and did not segregate program funds from other monies.

In fiscal year 1989, the Regional Inspector General conducted seven audits covering over $66 million for assistance projects. The audits disclosed problems with internal controls and accounting systems. The mission indicated that it was working closely with AID's Regional Inspector General to correct identified problems as soon as possible to reduce AID's financial exposure and had assigned one officer to work full-time tracking audit recommendations to ensure timely corrective action.
The mission believes that the audits have been helpful. AID officials also believe, however, that mission staff have spent much of their time responding to audit recommendations rather than fulfilling ongoing monitoring and control responsibilities. According to the mission, at any one time between 10 and 20 personnel in El Salvador are engaged in auditing, monitoring, and checking end use.

According to the AID Regional Inspector General, audit activity is generally a normal and nonburdensome activity that usually results in favorable opinions from the auditors. However, when agencies have inadequate financial systems, auditors' opinions are unfavorable and additional management effort is required to correct identified problems. He noted that the problem in El Salvador is not that too many audits are done but that actions to correct identified problems have required additional effort by mission personnel.

**Need to Better Identify Control Weaknesses**

Despite the mission's efforts to control funds, Salvadoran implementing agencies continue to be affected by serious internal control weaknesses that expose AID to substantial financial risk. To safeguard U.S. interests, AID is required to ensure that host country agencies have financial management systems in place. Mission assessments to ensure that agencies have adequate financial management capabilities are not identifying weaknesses before substantial money is disbursed. The Regional Inspector General has questioned more than $2.2 million in expenditures over the last year, mainly due to the lack of financial management capabilities of the implementing agencies.

**Assessing Financial Management Capabilities**

AID directives require the mission to review implementing agencies' capabilities regarding financial management, contracting, training, reporting, and other administrative functions. In our opinion, these assessments should determine if accounting systems and internal control weaknesses expose U.S. funds to significant risk.

According to AID, financial management assessments in the design stage can test overall project assumptions and identify additional project elements to address, such as internal controls. The directives indicate that the assessments should be completed early enough so that AID can include remedial assistance in the project design. To implement agency directives, mission procedures require financial analysts to assess the accounting and financial control systems of implementing agencies during the project development process.
Chapter 3
Economic Aid Program Controls

After we completed our fieldwork, the mission Director revised project design procedures to clarify AID responsibilities when new projects are planned. This revision requires controller analysts to ensure that sound financial cost projections are made and that recipients have effective systems for financial control, contracting, and payment. In addition, these analysts are required to determine the need for and number of audits for each project. Furthermore, if these financial management assessments show that an agency does not have the financial and management capability to administer project funds, AID must provide outside assistance until the organization develops the capabilities.

Weak Management Assessments

The mission Controller's office has only two qualified financial analysts capable of performing in-depth financial management assessments. Because of staffing limitations, the Controller must assign these staff other responsibilities, and according to the Controller, they cannot devote extensive time to financial management assessments. For example, one analyst is responsible for reviewing each expense under a $98 million earthquake recovery project and spends much time approving and certifying expenses.

In June 1989, an internal review of the Controller's office concluded that its staff are inexperienced and, as a result, have been unable to perform detailed financial management services. The assessment suggested that the Controller's office should play a larger role during the project design process but that the staff would first have to receive intensive training. The Controller agreed with this assessment but added that training staff has been difficult because direct-hire U.S. staff often leave the country before they have been fully trained, and foreign national employees have often taken higher paying jobs after being trained.

Mission staff responsible for planning and implementing projects told us that more detailed financial analyses were needed before funds are disbursed. The staff cited two recently contracted assessments as examples of the type of financial assessments that would permit them to adequately plan control systems to protect AID funds. Because it did not have internal staff available, the mission used outside contractors in 1989 to conduct detailed financial management assessments on two Salvadoran agencies. The studies involved an extensive review of the internal control systems of the Ministry of Public Works and the water department and identified numerous financial management weaknesses.
The studies reported that the internal audit department of the Ministry of Public Works was not staffed with qualified personnel but had a driver, an engineer, and two land surveyors. Other findings led the team to question the Ministry's ability to manage AID project funds. A separate review of the water department found that several prior AID projects with the water department could probably not be audited because record keeping was so poor. Both agencies are currently major participants in AID's $112 million public services restoration project.

Conclusions

Because of internal control deficiencies in the Salvadoran government and nongovernmental organizations used to implement AID projects, AID has increased audit activity and, within staffing constraints, emphasized project monitoring. Nevertheless, AID mission assessments are not identifying financial control weaknesses before substantial monies are disbursed.

Recommendations

We recommend that the Administrator, Agency for International Development, ensure that its mission in El Salvador (1) performs in-depth financial management assessments of Salvadoran organizations scheduled to implement new AID projects and (2) works with El Salvador to correct identified problems.

Agency Comments and Our Evaluation

AID generally concurred with our overall findings and indicated that our recommendations were already being implemented. AID commented that its mission in El Salvador has expanded the use of pre-award financial surveys of Salvadoran implementing institutions that have not previously received project funds, having completed 15 surveys in the last year. In addition, AID said that its mission is moving toward annual financial audits of all its programs as a primary means of assessing and reassessing accountability and internal controls. AID also reported that it has funded technical assistance to Salvadoran institutions and, in some cases, concurrent audits to overcome internal control deficiencies.

We believe that these actions will improve accountability for U.S. dollar-funded projects. However, in our opinion, the pre-award surveys do not assess overall management capacity of the implementing institution in sufficient depth to determine if it has the capability to manage AID projects properly and to account for project funds adequately. In contrast, the in-depth management assessments, which AID has funded in two recent cases, provide detailed reviews of all management aspects.
and as a result are more likely to identify deficiencies that need to be corrected before substantial funds are disbursed. Therefore, we believe that AID should expand the use of these in-depth assessments.
AID assistance agreements require that El Salvador set aside local currency funds to pay for development activities agreed upon with the United States. In fiscal year 1989, Salvadoran-owned local currencies made available as a result of U.S. Economic Support Fund cash grants and Public Law 480 Title I food sales agreements amounted to roughly 23 percent of El Salvador's total government expenditures. Because the Salvadoran government lacks adequate financial management and accounting systems, these funds are vulnerable to misuse. AID does not attempt to closely control all local currency uses. Although AID bears some responsibility for monitoring these funds, AID's policy guidance is ambiguous and does not specifically define what level of involvement is required.

The local currency program in El Salvador was designed to strengthen the government's capacity to plan, manage, and fund economic and social development programs. Local currency is generated from U.S. cash grants and food sales agreements, which over the last 3 years required that over 3 billion colones be set aside for mutually agreed-upon purposes. (See table 4.1.) According to AID, these funds are owned by El Salvador.

### Table 4.1: El Salvador Local Currency Program

<table>
<thead>
<tr>
<th>Fund source</th>
<th>1987</th>
<th>1988</th>
<th>1989</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dollars</td>
<td>Colones</td>
<td>Dollars</td>
</tr>
<tr>
<td>U.S. cash grants</td>
<td>$194</td>
<td>968</td>
<td>$157</td>
</tr>
<tr>
<td>U.S. food sales</td>
<td>46</td>
<td>230</td>
<td>38</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$240</strong></td>
<td><strong>1,198</strong></td>
<td><strong>$195</strong></td>
</tr>
</tbody>
</table>

On October 17, 1989, El Salvador agreed to set aside about 1 billion colones for expenditure in calendar year 1990 for the following purposes:

- AID trust fund—50 million colones,
- private sector credit—103 million colones,
- development and investment projects—517 million colones, and
- government operating expenses, such as salaries—371 million colones.

El Salvador operates its budget on a calendar year basis. Funds set aside in U.S. fiscal year 1989 are spent in calendar year 1990.
Chapter 4
Local Currency Is Vulnerable to Misuse

AID Trust Fund

The AID trust fund finances mission operation and maintenance costs. For example, trust funds are used to hire foreign nationals to monitor local currency projects. Each year, AID and El Salvador negotiate how much local currency will be deposited into the fund. In October 1989, El Salvador agreed to deposit 50 million colones, equivalent to $10 million, to pay for AID costs in calendar year 1990 or until fully expended. AID is the principal administrator of the trust fund and approves all disbursements. Because AID, rather than the Salvadoran government, directly controls these funds, AID officials believe the funds are less vulnerable to misuse than are other local currency funds that AID does not directly control.

Private Sector Credit

In October 1989, El Salvador agreed to use 103 million colones, equivalent to $21 million, on private sector credit lines for specific purposes such as agro-industrial loans. Through agreements between AID and the Central Bank, overall loan purposes, uses, and procedures are established. The Central Bank, not AID, controls the credit lines through the use of intermediate credit institutions that process and approve loans. AID requires the Central Bank to provide periodic progress and evaluation reports.

Since 1981, the Central Bank has made 11,733 local currency loans valued at $137 million. AID relies on the Bank's reports to monitor the program. A 1989 AID audit report stated that the credit lines provided El Salvador with needed banking system liquidity. Although the audit identified problems with loan recipients' use of the resources, a majority of the loans were being used for eligible purposes.

Extraordinary Budget Support

In 1983, because of administrative delays in disbursing local currency derived from external investment sources, the government of El Salvador, with AID's support, established a separate or extraordinary budget. According to an AID contracted assessment, the extraordinary budget lent flexibility and efficiency to government funding and implementation of local currency projects. AID convinced El Salvador to create a Technical Secretariat for External Finances, under the Ministry of Planning, to manage and monitor extraordinary budget programs and expedite the use of local currency development and investment funds. The extraordinary budget will receive 517 million colones, or the equivalent to $103 million, for calendar year 1990.
Local currencies from the extraordinary budget fund discrete projects planned jointly by AID and El Salvador. In 1989, over 150 projects implemented by more than 40 Salvadoran agencies were financed through the extraordinary budget. AID provides the Secretariat with technical assistance to plan, program, and approve these projects. AID policy does not state what level of accountability is required, nor does it specifically require that missions trace funds to end use. AID assistance agreements require the Secretariat to report quarterly on local currency use. Although these reports are AID's primary mechanism for monitoring extraordinary budget local currency projects, AID also conducts some project site visits.

AID Audits Identify Problems

In 1988, an AID audit on CONARA, a major user of local currencies, reported on financial irregularities and questioned expenditures equivalent to $1.3 million. Of this amount, AID concluded that the equivalent of $325,000 had been used for illegal transactions. Because the Director of CONARA was implicated in wrongdoing, the President of El Salvador directed that he be replaced. After the audit, AID contracted with an accounting firm to monitor all disbursements made by CONARA. AID's mission Director estimated the annual cost of monitoring CONARA programs at $1.36 million, of which $140,000 was for concurrent audits to monitor transactions as they occurred. The CONARA program received approximately $44 million, or 221 million colones, for expenditure in calendar year 1990. AID will continue funding concurrent audits at CONARA through fiscal year 1990.

AID officials told us that, as a result of the CONARA scandal, AID has become more aggressive in monitoring and auditing programs receiving local currency funds. For example, the Municipalities in Action Program, implemented by CONARA, provides local currency to mayors for hundreds of small-scale local community development projects. AID staff periodically visit project sites, and some staff work at CONARA regional offices. According to AID mission officials, the vulnerability to misuse of local currency funds used by CONARA is generally low because AID is heavily involved in monitoring programs. However, the mission Director said that staff levels are insufficient to monitor all uses of local currency as intensively as the mission monitors CONARA projects.

The AID mission in El Salvador has increased audit coverage of local currency projects. Working with AID, the Secretariat contracted with six accounting firms approved by the AID Regional Inspector General to conduct 59 audits of local currency projects. These projects involved 55
Salvadoran government organizations and covered local currency funds equivalent to over $300 million. At the time of our fieldwork, the Secretariat had received draft reports for each audit, which together indicated that the audited agencies have significant problems with internal controls and record keeping.

According to the Regional Inspector General, financial audits can provide four types of opinions concerning the state of financial records, internal controls, or compliance with agreement terms (unqualified, qualified, adverse, and disclaimer). As shown in table 4.2, almost half of the opinions indicated significant accounting system problems, and only 11 of the draft audit reports contained an unqualified auditor opinion.

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Number of audits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unqualified</td>
<td>No significant problems</td>
</tr>
<tr>
<td>Qualified</td>
<td>Limited identifiable problems with internal control systems</td>
</tr>
<tr>
<td>Adverse</td>
<td>Significant errors or accounting system problems</td>
</tr>
<tr>
<td>Disclaimer</td>
<td>No opinion due to significant accounting system problems</td>
</tr>
</tbody>
</table>

AID officials said that the quality of the drafts was inconsistent and that in some cases the local auditors had focused on insignificant problems. AID acknowledged, however, that the draft audits revealed serious accounting system and internal control problems. At the time of our fieldwork, AID was reviewing these draft reports to determine which problems required immediate corrective action and to decide if further funds should be suspended for some projects. In commenting on a draft of this report, AID indicated that the Secretariat would provisionally certify that implementing units are capable of managing and accounting for local currency funds and take necessary actions to correct deficiencies. If the Secretariat cannot provide certification after one year, either funding will be discontinued, or a concurrent audit will be funded to review transactions and provide technical assistance to clear up deficiencies.

According to the mission Director, improvements in the financial management systems of Salvadoran agencies are crucial to reducing the potential for misuse of local currency funds. Prompted by audit findings on local currency, AID has increased technical assistance to strengthen government financial systems. According to AID, this will help to reduce...
both opportunities for local currency misuse and the accountability and management burden on AID's staff.

The Secretariat, with AID's assistance, is working to improve organizations managing local currency funds. In 1988, an AID-contracted assessment of the Secretariat revealed weak and inefficient management control systems. With AID's assistance, the Secretariat initiated new accounting and internal control standards for implementing organizations and developed an audit group to perform and coordinate audits of these organizations. The Secretariat also designed a program to train personnel from implementing organizations on financial management and evaluation. AID is assisting the Secretariat in monitoring and implementing audit recommendations, prequalifying accounting firms to perform audits, and training Salvadoran government auditors responsible for examining and certifying the validity of all government expenditures prior to disbursement.

According to AID, El Salvador's new administration, which took office in June 1989, is attempting to combat fraud and corruption by drafting reforms to strengthen its financial, legal, and economic policies. The government has agreed to ensure that its agencies receiving extraordinary budget funds have adequate financial systems in place by 1991. Salvadoran and AID officials stated that due to the guerrilla insurgency and the magnitude of current financial management weaknesses, it will take time to implement these reform initiatives.

Ordinary Budget Support

Each year, AID and the government of El Salvador negotiate the amount of local currency to be provided for general budget support. In October 1989, El Salvador and AID agreed to use 371 million colones, equivalent to approximately $74 million, for general budget support in calendar year 1990. These funds, managed by the Ministry of Finance, pay for government operating expenses, such as salaries, which are part of the Salvadoran ordinary budget. These funds are not monitored or audited by AID at the same level as projects in the extraordinary budget. In addition, the Secretariat does not monitor these local currency funds. As a result, these funds are, in our opinion, more vulnerable to misuse.

Local currency in the ordinary budget is used to fund general government activities rather than discrete development projects funded by the extraordinary budget. AID approves the release of funds based on expenditure reports submitted by the Ministry of Finance. These reports describe general expense categories but do not detail how the funds are
spent. AID’s involvement is limited to a cursory documentation review rather than the actual planning and programming done for local currency channeled through the extraordinary budget. AID officials said that El Salvador has a system to verify that local currency was transferred to appropriate budgets and spent by targeted agencies. However, according to agency guidance, AID is not required to trace funds to actual end use, and therefore, AID does not ensure that the funds are used as intended.

When local currency is used to support general budget expenses, AID guidance requires the mission to ensure that documentation verifies that the local currency was transferred to the intended account, but it does not require AID to trace the funds to their end use. The guidance requires AID to have “reasonable assurance” that host governments have adequate financial systems to manage the local currency funds. At the time of our fieldwork, the AID mission had not reviewed the financial systems of government agencies implementing ordinary budget projects.

### Disadvantages to General Budget Support

Several factors make general budget support more vulnerable to misuse. First, neither AID nor the Secretariat has front-end involvement in planning and developing ordinary budget local currency projects. AID does not program, approve, or review the specific uses of these local currency funds and does not monitor end use. Second, general budget support activities have not been audited. During our fieldwork, AID contracted an accounting firm to review the Ministry of Finance’s financial control systems and render an opinion on the system’s adequacy. However, the Ministry of Finance does not actually spend these funds. It transfers them to ministries such as Health and Education, where they are commingled with other funds before being spent on ministry activities. Because the local currency funds are commingled with other funds to pay for ordinary budget expenses, end-use accounting of these currencies is not possible.

### Increased General Budget Support

Despite the disadvantages of using local currency for general budget support, AID plans to increase funds managed through the ordinary budget from 100 million colones, or $20 million, in calendar year 1989 to 371 million colones, or $74 million, for calendar year 1990. The Director of AID’s Office of Central American Affairs stated that the mission in El Salvador is increasing local currency amounts to support general budget expenses because agency guidance limits mission accountability and management burden for local currencies used in this way. The Director
attributed this change to recent AID audits that criticized the El Salvador mission for lax accountability over extraordinary budget projects and recommended actions to better account for end use—actions that mission officials believe will be difficult to fully implement, given the amount of local currency involved and AID staff limitations.

Although we recognize that close monitoring of local currency use places a management burden on AID's limited staff, we believe that increased general budget support will heighten the vulnerability of these local currency funds. Because El Salvador's financial management is generally weak and AID does not require end-use accountability for these funds, AID has no assurance that funds are used for intended purposes. Minimizing vulnerability of local currency, given AID staff constraints, is a problem that cannot be easily solved.

AID’s Guidance Is Ambiguous

AID's guidance for local currency accountability is ambiguous in defining the mission's level of accountability for local currency funds. The Director of AID's Office of Central American Affairs stated that clarifying local currency accountability has historically been a struggle for AID policymakers. Because of the growth in local currency programs worldwide, limited AID staff, and AID Inspector General policy interpretations, there is an ongoing effort to clarify AID policy.

In El Salvador, accountability for local currency is a subject of disagreement between AID mission personnel and AID auditors. The AID Regional Inspector General contends that the mission in El Salvador is accountable for tracing local currency to end use if the mission assists El Salvador in planning, programming, and approving extraordinary budget projects. In contrast, the AID mission believes it should be able to assist in planning and monitoring local currency activities without accepting full end-use accountability.

Recent AID policy guidance states that if missions program local currencies on a sectoral basis and the projects are not being undertaken by strong, highly respected host government or private sector institutions, missions should take a more "active role" in monitoring. Additionally, policy guidance requires missions to have "reasonable assurance" that host government agencies have adequate budget and financial management systems to ensure that local currency objectives are met. However, the policy does not specify what level of AID involvement would meet the "active role" and "reasonable assurance" requirements.
Chapter 4
Local Currency Is Vulnerable to Misuse

Conclusions

We believe that reducing the vulnerability of local currency funds can best be accomplished by improving El Salvador's financial management capability. AID is providing technical assistance to improve Salvadoran financial management systems. However, AID officials acknowledged that this is a long-term effort.

Although local currency is vulnerable to misuse, AID officials believe that AID oversight and monitoring tend to decrease vulnerability. However, AID has insufficient staff in El Salvador to closely monitor and account for all local currency uses. AID has chosen to support the ordinary budget by increasing the use of local currencies, which, according to agency guidance, require less monitoring effort. This action will lessen accountability of these funds and increase their vulnerability to misuse.

AID's guidance does not specifically require end-use accountability for local currency and does not clarify what level of accountability is required. Consequently, the issue of accountability has been a source of disagreement between AID mission personnel and the AID Regional Inspector General. We recognize that flexibility in local currency guidance is essential because of the political and economic environment in which AID operates. However, reaching full agreement on the level of accountability is critical, given the magnitude of El Salvador's local currency program, the limitation on AID staff levels, and the generally weak ability of Salvadoran institutions to manage and control funds.

Recommendations

We recommend that the Administrator, Agency for International Development, clarify AID's local currency accountability guidance for El Salvador. The guidance should clearly state (1) what constitutes reasonable assurance that host government agencies have adequate financial systems to manage local currency funds and (2) what degree of AID oversight and monitoring is required.

Agency Comments

AID generally concurred with our findings and recommendations. AID agreed that it had not defined what constitutes reasonable assurance that host government agencies have adequate financial systems to manage local currency funds. AID stated that it is preparing new operational guidance that better defines its criteria on reasonable assurance. According to AID, the new guidance will also specify how local currency accounts will be monitored and will require AID missions to perform financial assessments of host government units that administer local...
currency. In addition, AID commented that it is reviewing its accountability requirements for monitoring local currency to determine how they can be stated more clearly.
This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report; "EL SALVADOR: Accountability for U.S. Assistance," dated April 25, 1990 (GAO Code 463785/OSD Case 8318). With the exception of one recommendation, the DoD concurs with the GAO report.

The El Salvador Armed Forces and U.S. Military Group are already in the process of implementing the corrective actions recommended by the GAO. An Inspector General has been appointed. Other positions of responsibility have been established and filled to ensure accountability and control of material has been accomplished. A computer network has been installed to assist with inventory control and U.S. trainers are working more closely with their Salvadoran counterparts responsible for accountability and control of material and equipment in order to bring their system in line with the U.S. model.

The only recommendation that has not been accomplished to date is the El Salvador Armed Forces authorization for on demand spot checks. The DoD does not, however, consider a memorandum of understanding to be necessary or desirable to accomplish this recommendation. The DoD only disagrees with the mechanics, not the spirit, of the recommendation. An agreement, 13 United States Treaties 985, exists with regard to use, security and the observation, and review of defense articles and services. The DoD considers that any additional requirement could become a contentious issue in U.S. relations with El Salvador. It is the DoD position that the current agreement, as well as, the access to facilities and equipment afforded to U.S. personnel, is adequate. As an alternative to the memorandum of understanding, in order to provide the needed additional emphasis, the DoD will discuss 13 United States Treaties 985 during the semi-annual program management reviews held in April and November of each year between the U.S. and El Salvador. A specific request for access to facilities and inventory of selected items would be made a part of the action items to be accomplished following the program management reviews. During the next following program
management review, the results of the access and inventory will be evaluated for compliance.

The Department of Defense is pleased to have the opportunity to review and respond to the GAO draft report. The recommendations offered as a result of the GAO review were well received by the DoD.

Sincerely,

[Signature]

GLENN A. RUDD
ACTING DIRECTOR
Now on p. 8

FINDINGS

FINDING A: Background: U.S. Aid Programs to El Salvador.
The GAO reported that, since 1980, the U.S. has provided $3.5 billion of economic and military aid to El Salvador. The GAO explained that the U.S. aid programs provide military aid, balance-of-payment support, and assistance for development and humanitarian purposes. The GAO further explained that, prior to 1985, military assistance consisted of major end items such as vehicles and aircraft—but now the U.S. provides mainly consumables, such as ammunition, fuel, spare parts, and training. The GAO observed that El Salvador depends on U.S. economic aid, consisting of (1) cash transfers for balance-of-payments support, (2) concessional food sales and donations, and (3) projects affecting all civilian sectors (i.e., to restore infrastructure damages by war, to provide social services, and to attempt to reactivate El Salvador's economy).

The GAO commented that allegations of misuse and corruption have plagued the assistance programs and have been a continuing concern for the U.S. Government. The GAO had previously reported that El Salvador had improperly transferred U.S.-funded fuel to third parties without U.S. consent in violation of assistance agreements. The GAO added that there have also been instances of alleged misuse of economic aid. For example, the GAO noted that in 1984, allegations surfaced that U.S. cash transfers had been diverted to U.S. bank accounts. (p. 2, pp. 8-9/GAO Draft Report)

DoD Response: Concur. It should be noted that the DoD has already taken steps to correct the fuel issue addressed in the referenced prior GAO report. On December 4, 1989, the Defense Security Assistance Agency requested the Security Assistance Accounting Center to establish a separate Salvadoran holding account for proceeds of sales of Military Assistance Program funded fuels. Also on February 8, 1990,

See pp. 13-14.

the Defense Security Assistance Agency issued a change to DoD 5105.38-M, the Defense Security Assistance Management Manual, which provided guidance concerning resale proceeds of items purchased with U.S. financing. In addition to El Salvador, the resale guidance applies to Honduras, Israel, and the Philippines.

FINDING B: Military Assistance Program. The GAO reported that, from 1980 to 1989, the U.S. Government provided $958 million in military aid, of which $833 million was financed with Military Assistance Program grants and $107 million financed with Foreign Military Sales loan credits. The GAO explained that the Defense Security Assistance Agency administers U.S. military aid programs, while the U.S. Military Group in El Salvador manages the in-country program operations. The GAO reported that, for FY 1989, $64 million in U.S. military aid paid for ammunition, fuel, medical supplies, aircraft and vehicle maintenance to sustain military operations, and provided training. The GAO explained that the Foreign Military Sales program is administered under the authority of the Arms Export Control Act of 1976, which required that no defense article or service shall be sold or leased by the U.S. Government unless the recipient country agrees to:

- obtain consent of the President before transferring any defense article, service, or training to a third party or permit its use for purposes other than those furnished; and

- maintain the security of U.S. supplied articles or services and provide the same degree of security as provided by the United States.

The GAO further explained that all Foreign Military Sales agreements signed by the United States and El Salvador require the State Department's approval before El Salvador can transfer items to a third party. According to the GAO, El Salvador has not requested consent to transfer items. (pp. 2-3, pp. 12-16/GAO Draft Report)

DoD Response: Concur. The security requirements described by the GAO for articles acquired by Foreign Military Sales purchasers refers to the safeguarding of classified information and equipment. The security of U.S. supplied articles or services referred to in the GAO report regards physical security of articles acquired by Foreign Military Sales purchasers. El Salvador had no classified articles when the GAO review was conducted.
Appendix I
Comments from the Department of Defense

FINDING C: Some Sales Made Without U.S. Approval. The GAO referenced its August 1989 report, which found that the Salvadoran Air Force sold 61,107 gallons of military assistance program-funded fuel to the United States and to third parties, including an organization involved in re-supplying the Nicaraguan Democratic Resistance. In that prior report the GAO expressed concern that (1) third-party transfers had not been approved by the United States and, therefore, violated sales agreements between the U.S. and Salvadoran governments and (2) El Salvador was generating cash from sales of Military Assistance Program-funded fuel--which the GAO maintained was not intended by the Arms Export Control Act. In that prior report, the GAO also pointed out that the use of the cash revenues was not subject to U.S. control or approval. The GAO found that, concerned because the U.S. Government lacked control of fuel sales revenues, the U.S. Military Group developed a memorandum of understanding detailing the requirements for U.S. approval of fuel sales and other third-party transfers. The GAO further found that the Defense Security Assistance Agency has established procedures to credit U.S. payments for Military Assistance Program-funded fuel for future Foreign Military Sales to El Salvador.

The GAO concluded, however, that the Defense Security Assistance Agency had been refunding proceeds from U.S. purchases of Military Assistance Program-funded fuel to a Salvadoran account used for commercial purchases that are not reviewed or approved by the U.S. The GAO further concluded that, between June 1987 and September 1989, Salvadoran officials spent over $1.1 million of fuel sales proceeds to purchase items--including an automobile, camping equipment, and a $300,000 building, which the U.S. Military Group believes may have been overvalued. The GAO reported that the Financial Management Division of the Defense Security Assistance Agency was unaware that the DoD had planned to ensure proceeds from Military Assistance Program-financed fuel sales would be used only for Foreign Military Sales purchases and would not be made available to El Salvador for commercial purchase. The GAO noted that, on November 30, 1989, the Defense Security Assistance Agency directed its accounting center to discontinue refunding the proceeds from Military Assistance Program-funded fuel sales to an account controlled by the Government of El Salvador. The GAO further noted that fuel proceeds would now be deposited in an account that can be used only to finance Foreign Military Sales purchases--to ensure that the Defense Security Assistance Agency and the U.S. Military Group in El Salvador have the opportunity to review and approve all purchases financed with those funds. The GAO reported that
the Security Assistance Agency and the U.S. Military Group in El Salvador have the opportunity to review and approve all purchases financed with those funds. The GAO reported that the Security Assistance Manual will be modified to require that all recipient countries only use proceeds from sales of Military Assistance Program-funded fuel to finance purchases under the Foreign Military Sales program. (pp. 16-18/GAO Draft Report)

DoD Response: Concur. The GAO description of the situation in El Salvador during 1989 is accurate and the DoD concurs. Since that time, however, a separate trust fund account has been established for deposit of any proceeds from Military Assistance Program funded fuel sales. Those funds are not refunded directly to El Salvador and are available for Foreign Military Sales purposes. Further, a change has been made to the Security Assistance Management Manual, DoD 5105.38-M, which provides guidance concerning resale proceeds of items purchased with U.S. financing.

FINDING D: Limited U.S. Monitoring. The GAO reported that, in the absence of specific guidance, each member of the U.S. Military Group individually decides how much emphasis should be placed on monitoring responsibilities. The GAO found that, from May 1987 to April 1989, the Military Group conducted analyses of consumption data for ammunition, fuel, communication spare parts, batteries, medical supplies, and repair parts. According to the GAO, because of time and staff constraints and the absence of indications of diversion or misuse, some of the analyses had been discontinued or were limited to certain items—such as fuel and ammunition, which were viewed as the most critical items. The GAO further found, however, that the Military Group had not conducted inventories or spot checks of U.S. funded supplies and equipment on a regular basis. The GAO concluded that such inventories and spot checks could help El Salvador’s military to better control and account for U.S. military aid. The GAO further concluded that periodic spot checks of selected items by U.S. personnel assure that appropriate accountability procedures are in place to prevent pilferage, loss, or misuse of aid. The GAO commented that, according to the Military Group staff, such spot checks could be performed without significantly detracting from other responsibilities. The GAO also observed that staffing and travel restrictions, which keep U.S. military personnel from visiting combat areas, limit the extent to which U.S. personnel can monitor use of military aid in El Salvador. (pp. 2-3, pp.18-22/GAO Draft Report)
See pp. 20-21.

DoD Responses. Partially Concur. The El Salvador Armed Forces are aware of their responsibilities regarding equipment provided by the U.S. to El Salvador. It should be noted, however, that title to the material provided by the U.S. to El Salvador has passed to the Government of El Salvador. While the El Salvador Armed Forces facilities may not be of such quantity and quality as to afford the same level of physical security as the U.S., this does not indicate that storage or physical security is inadequate. The El Salvador Armed Forces are continually constructing new facilities and upgrading existing facilities to store and physically secure material. El Salvador is in the process, through Foreign Military Sales cases, of upgrading physical security at the Comalapa Air Base and the 4th Brigade. The DoD recognizes that improvements can and are being made. It is the DoD view that the existing and planned upgrades to facilities and logistics training respond to the GAO observations.

FINDING II: Salvadoran Controls Over Security Assistance. The GAO found that, because combat activities have been given the highest priority, logistics have not been emphasized—which has resulted in the Salvadoran forces receiving limited logistics training. The GAO further found that the number and quality of logistics personnel has not increased with the expanded military force size and the U.S. security assistance program. The GAO reported that, as a result, El Salvador's military relies on an antiquated logistical system. The GAO noted that low emphasis on logistics has been cited in U.S. assessments of El Salvador's military capabilities prepared in 1984 and 1985.

The GAO found that the El Salvadoran military logistics system is primarily supported by a manual paperwork process, with no standardized and systematic record keeping among the units. The GAO reported its spot checking indicated that the records contained conflicting information. The GAO further reported that, while El Salvador's military headquarters has established overall logistics policies and procedures for reporting receipt and distribution, conducting inventories, and accounting for military property—each military unit is required to develop its own standard operating procedures. The GAO further found that written logistics operating procedures were not in place at two of the 14 units the GAO visited. The GAO also reported that seven units had limited storage space, which resulted in some U.S.-funded supplies and equipment being inadequately secured. The GAO pointed out that the lack of adequate storage space for ammunition is critical because it could be (1) stolen, (2) affected by weather conditions, (3) sabotaged, or (4) accidently exploded. The GAO also found that physical inventories taken to reconcile records...
with actual equipment on hand were done infrequently. The GAO concluded that, based on 86 spot checks conducted at 14 units, the actual amount in the inventory was not accurately reflected in Salvadoran military accountability records. The GAO further concluded, however, that there was no evidence of any recent diversion or misuse of military assistance. In summary, the GAO nonetheless concluded that U.S. aid could be vulnerable to misuse or diversion because of control weakness. (pp. 3-4, pp. 22-31/GAO Draft Report)

DoD Response: Concur. The GAO review of the situation in El Salvador during 1989 is accurate and the DoD concurs. Since that time, however, changes have been made by El Salvador concerning accountability and control of material and equipment. A Colonel is in charge of logistics whose primary responsibility is to insure material and equipment accountability and control. There is also a clear chain of command for the logistics system which was not the case in the past. The Government of El Salvador has appointed an Inspector General, Vladimir Pineda Villalta, who will investigate allegations of irregularity in logistics matters. The El Salvador Armed Forces are conducting inventories of material with the assistance of U.S. personnel in order to bring accountability and control in line with the U.S. model.

FINDING II: Economic Aid Program Controls. The GAO reported that the Agency for International Development uses established policies and procedures to control direct assistance funds in El Salvador. According to the GAO, the Agency for International Development and the government of El Salvador have developed adequate systems to account for balance-of-payments aid—and the Agency monitors implementation, verifies expenses, and audits item end use for its projects and other activities. The GAO reported that, although it is the position of the Agency for International Development that U.S. funds are protected against misuse and diversion by Agency actions, that Agency's auditors have nonetheless found that some costs are not properly documented and are investigating two projects for possible misuse of funds. The GAO reported that, because the Salvadoran capacity to manage and control funds is generally weak, accountability for the Agency for International Development's annual program, which has averaged $250 million since 1980, has depended on a relatively small Agency staff in El Salvador to identify and correct control problems quickly. The GAO concluded that the Agency for International Development mission assessments are not identifying financial control weaknesses before monies are disbursed. (p. 4, pp. 33-51/GAO Draft Report)

DoD Response: The DoD notes the GAO finding.
FINDING G: Local Currency Is Vulnerable To Misuse. The GAO reported that the procedures of the Agency for International Development require that El Salvador set aside local currency funds to pay for development activities agreed upon with the United States. According to the GAO, in FY 1989, Salvadoran-owned local currencies, made available as a result of U.S. Economic Support Fund cash grants and Public Law 480 Title I food sales agreements, amounted to about 23 percent of El Salvador's total government expenditures. The GAO concluded that, because the Salvadoran government lacks adequate financial management and accounting systems, those funds are vulnerable to misuse. The GAO further reported that the Agency for International Development has insufficient staff to account for all local currency use. The GAO also found that about half of the Agency's Regional Inspector audits of Salvadoran agencies have identified significant accounting system problems. The GAO reported that El Salvador has agreed to ensure that its agencies have adequate financial systems in place by 1991.

The GAO also concluded that the Agency for International Development policy on local currency accountability is not clear. According to the GAO, the Regional Inspector General has taken the position that the Agency mission is, in fact, accountable for use of local currency funds. The GAO found, however, that because of staff constraints, the Agency for International Development mission is increasing the amounts of local currency spent on general expenses of the Salvadoran government—which, under Agency policy, requires less accountability. The GAO generally concluded that such practices could make the funds more vulnerable to misuse. (p. 4, pp. 52-67/GAO Draft Report)

DoD Response: The DoD notes the GAO finding.

* * * * *

RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense, after coordination with the Department of State, direct the Defense Security Assistance Agency and the U.S. Military Group in El Salvador to develop a memorandum of understanding with El Salvador for improving internal controls, to include the following.

- appointing independent high-level officials of the Salvadoran property accountability and Inspector General positions;
Appendix I
Comments From the Department of Defense

performing periodic inventories of Salvadoran Armed Forces property to ensure that accountability for their custody and use is maintained and to reconcile physical counts with records; and

authorizing the U.S. Military Group to conduct periodic spot checks of selected U.S. funded military items to provide reasonable assurance of accountability and control. (pp. 31-32/GAO Draft Report)

**DoD Response:** Partially Concur. The recommendations offered as a result of the GAO review were well received by the El Salvador Armed Forces, U.S. Military Group, and the DoD. The DoD does not, however, consider a memorandum of understanding to be necessary or desirable. A memorandum of understanding would do little to ensure or enhance accountability and control of U.S. funded material by the El Salvador Armed Forces. Instead, the Defense Security Assistance Agency will discuss and provide copies of 13 UST 985, "EL SALVADOR, Defense: Furnishing of Articles and Services," to the representatives of the El Salvador and U.S. Military Group during each semi-annual program management review. The program management reviews are held in April and November of each year in Washington, D.C. Prior to each review, a list of topics is prepared by the Defense Security Assistance Agency and provided to all participants. The El Salvador representatives at the program management review are the persons responsible for accountability and inventory control. During the review an action item list is developed which sets forth actions to be accomplished in a certain time frame and the agency responsible to complete the action. A copy of the list is provided to each participant. If problems occur between reviews regarding any action, the Defense Security Assistance Agency tries to resolve the issue. During the following review, the results of the previous review actions are discussed and the cycle begins again. The 13 UST 985 agreement, access, accountability and control can be made a topic and action item for each review.

A Salvadoran Colonel is in place in the armed forces logistics section to insure control and accountability of material and equipment. Since the GAO review, a clear chain of command has also been established to help alleviate problems of accountability and control.
Beginning in February 1990, the Salvadorans established a computer network for the Air Force which is assisting with accountability and control of all major end items and repair parts. This network is being expanded and will encompass the entire El Salvador Armed Forces.

The U.S. trainers in El Salvador have been working closely with their Salvadoran counterparts responsible for accountability and control of material and equipment in order to bring their system in line with the U.S. model. This includes record keeping procedures and inventory control.

The Government of El Salvador has appointed an Inspector General, Vladimirino Fineda Villalta, to investigate allegations of irregularities in logistics matters.

The U.S. Military Group is accompanying Salvadoran counterparts viewing Salvadoran equipment and facilities, as time and circumstances permit, to identify and correct any potential problems regarding accountability and control of U.S. funded equipment. However, the U.S. Military Group has not yet requested (nor have they received) authorization from the El Salvador Armed Forces for on demand access to all El Salvador Armed Forces facilities to spot check selected U.S. funded military items and facilities.

**RECOMMENDATION 2:** The GAO recommended that the Administrator, Agency for International Development, ensure that its mission in El Salvador (1) perform in-depth financial management assessments of Salvadoran organizations scheduled to implement new Agency for International Development projects and (2) work with El Salvador to correct identified problems. (p. 51/GAO Draft Report)

**DoD Response:** The DoD notes the GAO recommendation.

**RECOMMENDATION 3:** The GAO recommended that the Administrator, Agency for International Development, clarify the Agency's local currency accountability guidance for El Salvador, including a clear statement as to (1) what constitutes reasonable assurance that host government agencies have adequate financial systems to manage local currency funds and (2) what degree of Agency for International Development oversight and monitoring is required. (p. 68/GAO Draft Report)

**DoD Response:** The DoD notes the GAO recommendation.
The following is GAO's comment on the Defense Department's letter dated June 6, 1990.

GAO Comment

1. We agree that there are other ways to develop an adequate mechanism for discussing and reaching agreement on actions needed to improve control of U.S. military aid, and we have revised our recommendation accordingly.
AGENCY FOR INTERNATIONAL DEVELOPMENT

320 TWENTY FIRST STREET, N.W.
WASHINGTON, D.C. 20523

The Administrator

Mr. Frank C. Conahan
Assistant Comptroller: General
National Security and
International Affairs Division
General Accounting Office
Washington, D.C. 20548

June 15, 1990

Dear Mr. Conahan:

The Agency for International Development (A.I.D.) generally concurs with the GAO's overall findings in its draft report, "El Salvador: Accountability for U.S. Assistance." I would like to highlight four key conclusions contained in the report:

Now on p. 24.

A.I.D. uses established policies and procedures to control direct assistance funds in El Salvador. (p. 33)

Now on p. 27.

The system to control the delivery and sale of PL 480 agricultural commodities is adequate. (p. 39)

Now on p. 28.

The Regional Inspector General (RIG) does not believe that project funds are widely misused in El Salvador. (p. 41)

Now on p. 30.

A.I.D. staff are fulfilling monitoring responsibilities by helping implementing agencies overcome management weaknesses and conducting site visits -- often to war zone areas. (p. 45)

These conclusions of the GAO and the RIG, together with the detailed comments of the A.I.D. Mission in El Salvador (enclosed), suggest that the Mission is already implementing the recommendations at the end of Chapter 3 of the draft report. These recommendations state that the Administrator should ensure that the A.I.D. Mission in El Salvador: (1) perform in-depth financial management assessments of Salvadoran organizations scheduled to implement new A.I.D. projects; and (2) work with El Salvador to correct identified problems. (p. 51)

Now on p. 33.

Chapter 4 of the draft report concerns the management of host country-owned local currency. It recommends that the Administrator clarify A.I.D.'s local currency accountability guidance by defining: (1) what constitutes reasonable assurance
that host government agencies have adequate financial systems
to manage local currency funds; and (2) what degree of A.I.D.
oversight and monitoring is required.

A.I.D. Supplemental Guidance on Programming Local Currency
(A.I.D. Handbook 1, Part IV) is the basis on which USAID/El
Salvador and all missions administer local currency programs.
We have reviewed that guidance and agree that "reasonable
assurance" is not defined. Indeed, the guidance implicitly
assumes that each mission is in the best position to judge
whether or not the institution designated to receive local
currency funds is, or is not, able to manage the funds properly.

The guidance defines A.I.D.'s "oversight and monitoring"
responsibilities in the context of the degree to which A.I.D.
is involved in jointly programming the host country-owned local
currency. When the funds are jointly programmed to support
budget requirements, the guidance explicitly states that
A.I.D.'s role may be limited to ensuring that the local
currency was actually transferred to the appropriate account,
and that the funds need not be traced to their end use because
they will have been combined with other funds and will not be
traceable.

The Agency is currently preparing operational guidance
which will require missions to perform financial assessments of
the host government units which administer local currency
special accounts; indicate how special accounts will be
monitored and reported on; and ensure that audits are performed
on local currency special account activities. This operational
guidance will also better define what constitutes "reasonable
assurance" that host governments have adequate financial
systems to manage local currency resources. We are also
reviewing A.I.D.'s accountability requirements for monitoring
host country-owned local currency to determine how these
requirements can be stated more clearly.

I believe that these new guidelines will be responsive to
the local currency recommendations identified in the draft
report.

Enclosed are the Mission's more detailed comments on the
report.

Sincerely,

Ronald W. Roskens

Enclosure: as stated
USAID/El Salvador Comments on GAO Draft Report:

"El Salvador: Accountability for U.S. Assistance"

A. Financial Control of Development Assistance

The draft report recommends that the Administrator, Agency for International Development, ensure that its mission in El Salvador (1) perform in-depth financial management assessments of Salvadoran organizations scheduled to implement new A.I.D. projects and (2) work with El Salvador to correct identified problems. Four major procedures are used by the Mission to monitor and assure accountability.

1. Pre-award Surveys. Generally, monies are not disbursed to new implementing institutions until a pre-award survey has been completed and internal control deficiencies have been resolved. During the last 12 months alone, the Mission has completed 15 pre-award surveys of new implementing institutions and another 2 pre-award surveys are currently in process, for a total of 17; see Table 1. The RIG managed 7 of these surveys; see Table 2.

2. Financial Audits/Reviews. Development assistance programs in El Salvador are audited on a regular basis. The Mission is moving toward annual financial audits of all programs. These financial audits provide the mission with the primary means of assessing and reassessing accountability and internal controls before additional funds are disbursed or new grants are signed with implementing entities already receiving A.I.D. funds. During the last 12 months alone, the Mission has completed 12 financial audits/reviews and another 17 are currently in process, for a total of 29; see Table 1. In addition, local PVOs funded by A.I.D. are required to have annual financial audits performed by U.S.-affiliated CPA firms; 7 of these audits were performed last year; see Table 2.

3. Technical Assistance. When the financial audits/reviews indicate deficiencies in internal controls and accountability, the Mission often resolves these problems by providing technical assistance from U.S.-affiliated CPA firms or other institutional contractors. This approach to strengthening accounting systems by providing technical assistance has helped close 63 audit recommendations and resolve another 47 recommendations.

4. Concurrent Audits/Monitoring. When the financial audits reveal serious deficiencies (or irregularities) which cannot be resolved in a relatively short time, the Mission discontinues funding or continues funding subject to the installation of an on-site concurrent financial audit or
Appendix II
Comments From the Agency for International Development

- 2 -

financial monitoring engagement. Currently there is one concurrent audit and one financial monitoring arrangement in operation for development assistance programs; see Table 1.

B. Financial Control of Local Currency

The Draft Report recommends that the Administrator, Agency for International Development, clarify A.I.D.'s local currency accountability guidance for El Salvador. This clarification should clearly state (1) what constitutes reasonable assurance that host government agencies have adequate financial systems to manage local currency funds, and (2) what degree of A.I.D. oversight and monitoring is required.

The primary means of monitoring accountability and assessing internal controls for local currency rests with two Salvadoran agencies, the Court of Accounts and the Technical Secretariat for External Financing (SETEFE). Working through the Court of Accounts and SETEFE, the Mission obtains reasonable assurance that funding objectives are met. As explained below, the Mission believes that it has properly implemented A.I.D. policy to monitor the use of host country-owned local currency funds.

1. The Court of Accounts, with a fulltime staff of 913, is responsible for auditing all government agencies. The Mission has been working with the Court of Accounts since 1986 in an effort to modernize its audit systems. A contract funded by A.I.D. was signed with Price Waterhouse to train its staff; evaluate its operations; and recommend changes to its systems, organization, and authorizing legislation. To date 125 employees of the Court of Accounts have been trained in governmental accounting and 822 have been trained in modern fiscal control. In May 1990, the Court announced publicly its plan to implement the numerous changes recommended by the Price Waterhouse study. The Mission is pleased with the progress to date and the new direction at the Court.

2. SETEFE was encouraged by the Mission in 1985 to hire CPA firms to audit all of the implementing units receiving funds from the extraordinary budget. SETEFE implemented contracts to carry out some 55 audits for the period 1984/85, and the Mission contracted with a consulting firm to verify the implementation status of the recommendations resulting from these audits. The Mission concurrently asked the RIG to provide training materials to SETEFE on GAO auditing standards, and asked prequalified U.S.-affiliate CPA firms to perform the work. The RIG provided guidelines to the SETEFE audit supervisor as well as on the job training concerning work plans, work papers, sampling
techniques, etc. As a result, 62 audits covering the period from January 1986 to June 1988 were performed in 1989 using GAO auditing standards; see Tables 1 and 2.

3. As a result of the success of this audit process, the Mission and SETEFE entered into an agreement in 1990 whereby SETEFE would provisionally certify that implementing units are capable of managing and accounting for local currency funds. During this one year provisional period, all necessary actions to correct deficiencies will be taken. If SETEFE is unable to provide final certification of an implementing unit, either funding will be discontinued or an agreement will be reached to initiate or continue a concurrent audit to review transactions and provide technical assistance to clear up the deficiencies.

4. For ordinary budget support, the Ministry of Finance provides A.I.D. with a programming proposal which identifies areas of activities, such as education and health, to be funded. After the ordinary budget support program is approved by A.I.D., the Ministry of Finance reports to A.I.D. the disbursements made by Ministries against the original agreement. In this way and in accordance with A.I.D. policy the Mission ensures that documentation exists to demonstrate that local currency was transferred to appropriate budget accounts for disbursement.

C. Mission Efforts to Improve Accountability

The Mission concurs with the RIG that audits are integral to assuring proper control of funds and effective program implementation for both development assistance programs and local currency programs.

1. During the last 12 months 103 audit reports have been completed for development assistance programs, either in draft or in final; see Table 2. The Mission takes great pride in having closed 63 audit recommendations and resolved another 47 during this period. The closure and resolution of these recommendations clearly demonstrates the Mission's commitment and continued progress in improving accountability of the development assistance program.

2. Regarding the local currency program SETEFE is primarily responsible for monitoring the resolution and closure of the recommendations that have resulted from its 62 financial audits of various Government of El Salvador implementing agencies during the past 12 months; see Tables 1 and 2. SETEFE uses GAO auditing standards and is assisted by the implementing agencies, the Court of
Accounts, and Price Waterhouse. The Mission monitors the progress of these efforts to improve internal control.

Table 1 summarizes the audits/reviews completed or in process for both development assistance and host country-owned local currency during the last 12 months. Table 2 summarizes the audit reports issued and in process during the last 12 months.

### TABLE 1.--Audits/Reviews Completed or in Process During the 12 Month Period June 1989 - May 1990

<table>
<thead>
<tr>
<th>Type of Audit/Review</th>
<th>Development Assistance</th>
<th>Local Currency</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-award Surveys</td>
<td>17</td>
<td>2</td>
<td>19</td>
</tr>
<tr>
<td>Financial Audits/Reviews</td>
<td>29</td>
<td>2</td>
<td>31</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Concurrent Audits/Monitoring</td>
<td>2</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>SETEFE Annual Financial Audits by U.S.-Affiliated CPA Firms</td>
<td>0</td>
<td>62</td>
<td>62</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>49</strong></td>
<td><strong>70</strong></td>
<td><strong>119</strong></td>
</tr>
</tbody>
</table>

### TABLE 2.--Audit Reports Issued and in Process During the 12 Month Period June 1989 - May 1990

<table>
<thead>
<tr>
<th>Type of Audit Report</th>
<th>Final Reports</th>
<th>Draft Reports</th>
<th>Total</th>
<th>In Process</th>
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</thead>
<tbody>
<tr>
<td>RIG Pre-award Audits</td>
<td>6</td>
<td>1</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>Non-RIG Pre-award Audits</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td>RIG Financial Audits</td>
<td>12</td>
<td>1</td>
<td>13</td>
<td>7</td>
</tr>
<tr>
<td>GAO Audits</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Financial Reviews</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Financial Audits of Local PVOs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SETEFE Annual Financial Audits by U.S.-Affiliated CPA Firms</td>
<td>7</td>
<td>0</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>25</strong></td>
<td><strong>37</strong></td>
<td><strong>62</strong></td>
<td><strong>17</strong></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>62</strong></td>
<td><strong>41</strong></td>
<td><strong>103</strong></td>
<td><strong>17</strong></td>
</tr>
</tbody>
</table>
Dear Mr. Conahan:

This is in response to your letter of April 25, 1990, which forwarded copies of the report entitled "El Salvador: Accountability for U.S. Assistance" (code 463785) for review and comment.

Enclosed are brief comments prepared by the Bureau of Inter-American Affairs.

We appreciate the opportunity to review and comment on the draft report.

Sincerely,

Elizabeth A. Gibbons
Associate Comptroller
Office of Financial Management

Enclosure:
As stated.

Mr. Frank C. Conahan
Assistant Comptroller General,
National Security and International Affairs Division,
U.S. General Accounting Office,
Washington, D.C. 20548
Appendix III
Comments From the Department of State


I appreciate the opportunity to review and comment on the GAO's draft report on assistance to El Salvador. While deferring to the Department of Defense and the Agency for International Development for a detailed response to the GAO's findings and recommendations, I would note only that it is encouraging to have established that U.S. assistance to El Salvador, with only a few exceptions, has been used for the purposes for which it was intended. The corrective measures recommended in your report and those already being implemented by AID and the U.S. Military Group in El Salvador, further ensure the integrity of our assistance program.

Michael G. Kozak,
Acting Assistant Secretary
for Inter-American Affairs
Appendix IV

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