

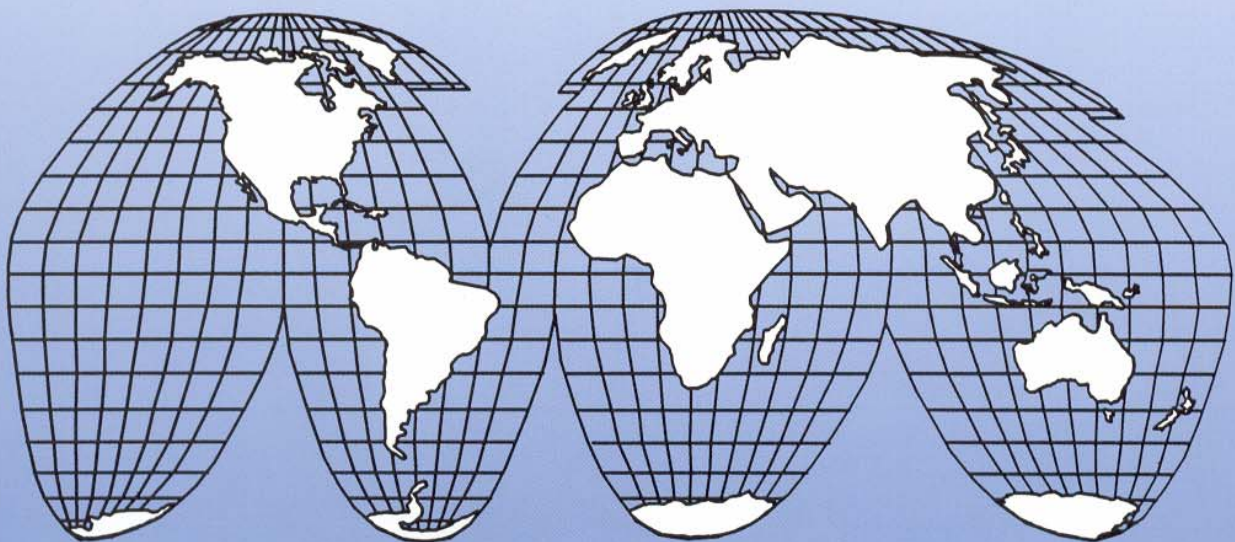
USAID

OFFICE OF INSPECTOR GENERAL

Audit of USAID/Guatemala-Central American Programs' Cooperative Agreement with Caribbean-Central American Action (Cooperative Agreement No. 596-A-00-04-00235-00)

Audit Report Number 9-596-05-003-P

February 7, 2005



Washington, D.C.



February 7, 2005

MEMORANDUM

FOR: USAID/G-CAP Director, Glenn Anders

FROM: IG/A/PA, Nathan S. Lokos /s/

SUBJECT: Report on Audit of USAID/Guatemala-Central American Programs' Cooperative Agreement with Caribbean-Central American Action (Cooperative Agreement No. 596-A-00-04-00235-00) (Report No. 9-596-05-003-P)

This memorandum transmits our final report on the subject audit. In finalizing the report, we considered your comments on our draft report and have included your responses as Appendix II.

This report includes one recommendation to address a lobbying issue raised by the wording in the Declaration of Principles mentioned in the cooperative agreement. In your written comments, you concurred with the recommendation and have identified actions to address our concerns. Therefore, we consider that a management decision has been reached and that final action is pending on the recommendation. Information related to your final action should be provided to USAID's Office of Management Planning and Innovation.

I want to express my sincere appreciation for the cooperation and courtesies extended to my staff during the audit.

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Summary of Results

The U.S.-Central America Free Trade Agreement (CAFTA) was signed by the United States and several Central American countries on May 28, 2004. Enacting the agreement requires that the U.S. Congress pass implementing legislation and that similar action be undertaken in the other countries. CAFTA was negotiated, in part, as a regional agreement in which all parties would be subject to the “same set of obligations and commitments.” As a comprehensive and reciprocal trade agreement, CAFTA defines detailed rules that would govern market access of goods and services. (See page 6.)

This audit is a result of a request from Congress asking for a review and independent assessment of a cooperative agreement to Caribbean-Central American Action (CCAA) providing initial funding for the Alliance for CAFTAction. (See page 7.)

In responding to this request, the Performance Audits Division of the Office of Inspector General conducted this audit to determine whether (1) USAID/Guatemala-Central American Programs (USAID/G-CAP) complied with Section 533 restrictions of the Foreign Operations provisions of Public Law 108-199 and Automated Directives System 225 in the award of its cooperative agreement to CCAA, (2) the cooperative agreement with CCAA complied with selected Federal Appropriations Law provisions as they apply to obligating appropriated funds, and (3) the cooperative agreement with CCAA complied with Federal and USAID lobbying restrictions. (See page 7.)

The audit concluded that USAID/G-CAP complied with Section 533 restrictions of the Foreign Operations provisions of Public Law 108-199 and Automated Directives System 225 in the award of its cooperative agreement to CCAA. Similarly, the audit concluded that the cooperative agreement to CCAA complied with selected Federal Appropriations Law provisions as they apply to obligating appropriated funds. (See pages 8 and 10.)

Finally, the audit determined that the cooperative agreement to CCAA did not initially fully comply with Federal and USAID lobbying restrictions. The agreement program description called for business and civil society leaders to sign the “Declaration of Principles” which—among other things—asked for business partners, friends and families in the United States to support efforts to ratify the Central American Free Trade Agreement. This activity could be considered an attempt to influence the enactment of pending U.S. Federal legislation, which is not allowed under

Federal lobbying restrictions. However, after we made contact with USAID/G-CAP, CCAA made two revisions to the Declaration of Principles, the last of which deleted all references to working for the ratification of CAFTA. We recommended that the Mission require CCAA to use the most recent Declaration of Principles, which omits any reference to either ratification of CAFTA or the United States. (See pages 12 and 13.)

Management concurred with the recommendation and described actions taken to remove all references to “involving U.S. friends” or “asking for help in the ratification of CAFTA” from the Declaration of Principles. Management also described additional monitoring of the cooperative agreement with CCAA that it intends to perform. (See page 14.)

Background

The U.S.-Central America Free Trade Agreement (CAFTA) was signed by the United States Trade Representative and several Central American countries on May 28, 2004. Enacting the agreement requires that the U.S. Congress pass implementing legislation and that similar action be taken in the other countries. CAFTA was negotiated, in part, as a regional agreement in which all parties would be subject to the “same set of obligations and commitments,” but with each country defining separate schedules for market access on a bilateral basis. As a comprehensive and reciprocal trade agreement, CAFTA defines detailed rules that would govern market access of goods, as well as services trade, government procurement, intellectual property, and investment.

Under CAFTA, more than 80 percent of U.S. consumer and industrial exports and over half of U.S. farm exports would become duty-free immediately. To address asymmetrical development and transition issues, CAFTA specifies rules for tariff phase-out schedules as well as transitional safeguards and tariff rate quotas for sensitive goods. Although many goods would attain immediate duty-free treatment, others would have tariffs phased out incrementally so that duty-free treatment is reached in 5, 10, 15, or 20 years from the time the agreement takes effect.

On September 30, 2004, USAID/Guatemala-Central American Programs (USAID/G-CAP) awarded a cooperative agreement to Caribbean-Central American Action (CCAA), a private, independent, non-profit organization headquartered in Washington, D.C.¹ The organization is governed by an international Board of

¹ USAID/G-CAP awarded Cooperative Agreement No. 596-A-00-04-00235-00 for the Alliance for CAFTAction. The document was incrementally funded for 10 months of the

Trustees and funded primarily by contributions from companies with a direct or indirect stake in the region's prosperity. CCAA describes its activities as those of promoting private sector-led economic development in the Caribbean basin and throughout the hemisphere, in order to serve its goal of facilitating trade and investment to improve the policy and regulatory environments for business on both the international and local levels.

This audit resulted from a Congressional request asking for a review and independent assessment of USAID/G-CAP's cooperative agreement providing initial funding for the Alliance for CAFTAAction. Congress' concern was that activities under the agreement associated with CAFTA might not be consistent with Section 533 of the Foreign Operations provisions of the relevant Appropriation Act (Public Law 108-199), which prohibits funding of incentives with the purpose of inducing businesses to relocate outside the United States—if the likely result would be the loss of U.S. jobs. The request asked that the Office of Inspector General ascertain whether the agreement is in compliance with Section 533 of the Appropriations Act and whether USAID internal guidance.

Audit Objectives

This audit was requested by Congress and was conducted to answer the following questions:

Did USAID/Guatemala-Central American Programs comply with Section 533 restrictions of the Foreign Operations provisions of Public Law 108-199 and Automated Directives System 225 in the award of its cooperative agreement to Caribbean-Central American Action?

Did USAID/Guatemala-Central American Programs' cooperative agreement with Caribbean-Central American Action comply with selected Federal Appropriations Law provisions as they apply to obligating appropriated funds?

Did USAID/Guatemala-Central American Programs' cooperative agreement with Caribbean-Central American Action comply with Federal and USAID lobbying restrictions?

Appendix I contains a discussion of the audits scope and methodology.

planned 2 year scope of work with an obligation totaling \$300,000 out of a planned budget of \$700,000. As a Global Development Alliance, the agreement is expected to leverage an additional \$1,400,000 of funds from participating alliance partners.

Audit Findings**Did USAID/Guatemala-Central American Programs comply with Section 533 restrictions of the Foreign Operations provisions of Public Law 108-199 and Automated Directives System 225 in the award of its cooperative agreement to Caribbean-Central American Action?**

USAID/G-CAP did comply with Section 533 restrictions of the Foreign Operations provisions of Public Law (P.L.) 108-199 (Section 533) and Automated Directives System (ADS) 225 in the award of its cooperative agreement to Caribbean-Central American Action (CCAA). The cooperative agreement's activities fall under the category of permitted activities, which are activities that, even though they have a trade and investment orientation, by their nature are too indirectly linked to any potential location or are not consciously directed at inducing a business to relocate. There were no activities that appeared to be designed to directly induce U.S. businesses to either relocate abroad or to relocate jobs abroad. Moreover, there were no activities—such as establishing investment promotion offices or funding media advertising in the U.S. directed at investment promotion—that would likely evolve into activities prohibited by the ADS.

Section 533 states that none of the funds appropriated under the Act (P.L. 108-199) may be obligated or expended to provide any financial incentive to a business enterprise currently located in the U.S. for the purpose of inducing such an enterprise to relocate outside of the U.S. if such incentive or inducement is likely to reduce the number of employees because U.S. production is being replaced by production overseas. Similarly, ADS Section 225 establishes the policies and procedures to implement Section 533 of the Act. It contains program design and implementation procedures to ensure that USAID-funded “trade and investment” activities do not provide financial incentives and other assistance for U.S. companies to relocate abroad if it is likely to result in the loss of U.S. jobs.

ADS 225 classifies “trade and investment” activities into three categories containing illustrative examples. These areas are “permitted,” “prohibited,” and “gray-area.” Permitted activities are those that, by their nature, would be too indirectly linked to any potential relocation of U.S. businesses or are not consciously directed at inducing U.S. businesses to relocate. Prohibited activities are those that represent too high a risk of being directly linked to a potential relocation. The gray-area activities are those requiring further review and consideration in the design process to

determine the likely impacts on jobs and relocation. USAID/G-CAP officials stated that, in their review of the proposal for the cooperative agreement, they concluded that all of the activities contemplated under the agreement were permitted activities, as defined in ADS 225.

We examined the activities included in the cooperative agreement, CCAA's annual work plan and the monitoring and evaluation plan to determine whether the activities therein were directed at promoting foreign investment or could reasonably be foreseen to stimulate the relocation of any U.S. business that would result in a reduction in the number of employees of the business in the U.S. We also discussed these issues with USAID/Washington and USAID/G-CAP staff.

The specific activities associated with the agreement fell into the following categories:

- Creating a network of business and civil society leaders in Central America to implement CAFTA.
- Bringing together key leaders in each Central American country to promote CAFTA.
- Working with private sector organizations in Central America to provide training for employees of member companies on the benefits of CAFTA's implementation.
- Working with other Central American business organizations to define "best business practices" and develop public/private partnerships that will help businesses implement these practices.

We determined that the agreement's activities fell under the category of permitted activities, and found no activities that could be considered prohibited or gray-area activities, as defined by ADS 225. Nor did we find any activities that appeared to be designed to directly induce U.S. businesses to either relocate abroad or to relocate jobs abroad. Consequently, we concluded that the cooperative agreement did not violate either Section 533 or ADS 225.²

²Even though Mission staff considered the activities under the agreement to be permitted activities, they took the additional step of including a clause addressing "Investment Promotion" in the cooperative agreement. This clause prohibits the use of agreement funds for investment promotion unless specified in the cooperative agreement or authorized by USAID in writing.

Did USAID/Guatemala-Central American Programs' cooperative agreement with Caribbean-Central American Action comply with selected Federal Appropriations Law provisions as they apply to obligating appropriated funds?

USAID/G-CAP's cooperative agreement to Caribbean-Central American Action did comply with selected Federal Appropriations Law provisions as they apply to obligating appropriated funds. The funding document was an authorized cooperative agreement in which the anticipated results are intended to benefit a third party. Additionally, the funds obligated under the agreement met the required elements necessary for legal availability.

The Federal Grant and Cooperative Agreement Act of 1977 (31 USC 6301 to 6308) defines a procurement contract as a funding vehicle to be used when "the principle purpose of the instrument is to acquire property or services for the direct benefit or use of the United States Government." Alternatively, grants and cooperative agreements are to be used when "the principal purpose of the relationship is to transfer a thing of value [money, property, services, etc.] to the ...recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring ...property or services for the direct benefit or use of the United States Government."

Key elements in determining whether an appropriation has been used within its "legal availability" in funding a cooperative agreement include the purpose, time and amount of the obligation.³ Appropriations may be used only for the purpose(s) for which they were made and, must be obligated by the agency within their period of obligational availability; further the amount of grant funds must meet earmark or other controlling provisions in the applicable program statute. In addition, Federal government activities must be for a *bona fide* need. USAID/G-CAP's cooperative agreement to CCAA met all of these requirements.

First, the general purposes of the agreement fall under the intended purposes of the Foreign Operations, Export Financing and Related Programs Appropriation Act for Development Assistance funds, which includes the promotion of economic growth by strengthening the private sector. Therefore, the cooperative agreement meets the purpose test.

³GAO's *Principles of Federal Appropriation Law, Chapter 10*.

Second, the cooperative agreement also met the time test. The funds in question are fiscal year 2004 Development Assistance funds and were obligated on September 30, 2004, within their period of obligational availability. Moreover, the scope of work for the agreement is two years, which is less than the 5-year maximum provided under the Appropriations Act.

Third, the cooperative agreement also met the amount test. Under this test, the amount of grant funds must meet earmark or other controlling provisions in the applicable program statute. The funds obligated by USAID/G-CAP under this agreement were funds provided by USAID's Global Development Alliance (GDA) Secretariat and were reported under the GDA program to Congress in Congressional Notification #232, dated July 13, 2004. Providing Congress with programmatic and funding details for the Development Assistance-funded GDA Incentive Fund, the Notification reported the obligated \$300,000 to be within applicable earmark appropriation provisions for the program. Therefore, the agreement and its obligated funds meet the standards for the amount test.

Finally, the cooperative agreement met the *bona fide* needs rule, which applies to all Federal government activities carried out with appropriated funds, not just contracts, but also grants and cooperative agreements. GAO's *Principles of Federal Appropriation Law, Chapter 5*, states that a *bona fide* needs analysis in the grant and cooperative agreement context focuses on whether the grant was made during the period of availability of the appropriation charged and furthers the authorized purpose of program legislation. Since the funds for the subject cooperative agreement were obligated during the period of availability (on September 30, 2004) for an authorized purpose of the program legislation (economic growth by strengthening the private sector), it met the *bona fide* needs test by satisfying USAID's "need" to provide recipients with financial assistance through the awarding of grants and cooperative agreements.

In consideration of the above, we conclude that USAID/G-CAP's cooperative agreement to CCAA did comply with selected Federal Appropriations Law as it applies to awarding cooperative agreements and obligating appropriated funds.

Did USAID/Guatemala-Central American Programs' cooperative agreement with Caribbean-Central American Action comply with Federal and USAID lobbying restrictions?

USAID/G-CAP's cooperative agreement with Caribbean-Central American Action did not fully comply with Federal and USAID lobbying restrictions. Although the actual agreement complied, language in a document used under the agreement conflicted with lobbying restrictions. This issue is discussed below.

Language Does Not Comply With Lobbying Restrictions

USAID uses standard provisions in its agreements with U.S. nongovernmental recipients. The cooperative agreement USAID/G-CAP has with CCAA references the provisions found in 22 CFR 226, which incorporate the cost principles in OMB Circular A-122. Circular A-122 establishes principles for determining the allowable costs that can be charged to the Federal government by non-profit organizations, such as CCAA. The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. The principles are to be used by all Federal agencies in determining the costs of work performed by non-profit organizations under cooperative agreements.

The cost principles in Circular A-122 state that lobbying costs are unallowable. Specifically, this refers to any attempt to influence the enactment or modification of any pending Federal legislation through communication with any member or employee of the Congress, or with any Government official or employee in connection with a decision to sign or veto enrolled legislation. Also unallowable is any attempt to influence the enactment or modification of any pending Federal legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fund raising drive, lobbying campaign or letter writing or telephone campaign.

While the cooperative agreement does not explicitly mention lobbying, in the program description, under the category of Leadership activities, it does mention that CCAA will "[w]ork with respected individuals from the business community and civil society in each country to create a broad-based regional network that, by signing the Declaration of Principles (the Declaration),

publicly commit time and resources to driving forward the successful implementation of CAFTA...” Leaders signing this document are declaring that they urge the timely ratification and implementation of CAFTA.

Moreover, these leaders are also declaring that “[w]e ask our “business partners (investors, employees, customers, suppliers, head offices, etc.), friends (NGOs, donors, etc.) and families *in the United States to support our efforts to ratify and implement CAFTA...*” [emphasis added]. In our opinion, by asking business partners, friends and families in the U.S. to support efforts to ratify CAFTA—which has not yet been ratified by the U.S. Congress—this declaration is attempting to influence the enactment of CAFTA by the United States and is a violation of the cost principles contained in OMB Circular A-122.

Subsequent to our contact with USAID/G-CAP, the Mission reported that the Declaration had been clarified. This clarification consisted of eliminating the reference to the United States. However, the Declaration still called for business partners, friends and families to support efforts to ratify CAFTA. Although, this action was no longer targeted at the United States, calls for supportive efforts to ratify CAFTA in the U.S. were not excluded. When we brought this to the attention of USAID/G-CAP, the Mission replied that the intent of the Declaration was always meant to engage business leaders and civil society sector leaders to “lobby” in their own country for the ratification of CAFTA. The Declaration was then revised again by deleting any reference to ratification and explicating focusing on implementation in Central America.

We are making the following recommendation to ensure that leaders signing the Declaration use the most recent version which omits any reference to either the ratification of CAFTA or to the United States.

Recommendation No. 1: We recommend that the USAID/Guatemala-Central American Programs require that Caribbean-Central American Action use the most recent version of the Declaration of Principles which omits any reference to either the ratification of CAFTA or the United States.

**Management
Comments
and our
Evaluation**

USAID/Guatemala-Central American Programs (USAID/G-CAP) concurred with our recommendation and described actions taken to remove all references to “involving U.S. friends” or “asking for help in the ratification of CAFTA” from the body of the Declaration of Principles that the Caribbean-Central American Action (CCAA) Alliance members signed as part of their commitment. CCAA will request all new CCAA Alliance members to sign the revised version of the Declaration of Principles. Moreover, the mission states that CCAA will send a Clarification Letter to all Alliance members that signed the original Declaration stating that the Alliance program supports activities exclusively in the Central American Region and that the program supports activities to implement CAFTA rather than to ratify CAFTA. USAID/G-CAP plans to add a monitoring clause to CCAA’s Monitoring and Evaluation Plan and the cognizant technical officer will monitor any and all information being released to the public. We believe the actions taken and on-going monitoring plans adequately address our concerns.

Scope and Methodology

Scope

The Performance Audit Division conducted this audit in accordance with generally accepted government auditing standards. We conducted the audit field work at USAID/Washington from November 24, 2004 to January 25, 2005. For documentation regarding the cooperative agreement and its associated activities, we contacted program officials at USAID/Washington and USAID/Guatemala-Central American Programs (USAID/G-CAP). The scope of the audit was limited to activities conducted since the awarding of the agreement, as well as proposed activities.

The scope of the audit included an examination of the internal controls associated with the awarding and managing of the cooperative agreement with Caribbean-Central American Action (CCAA). We found no relevant audit findings affecting the areas reviewed.

Methodology

In order to gain an understanding of USAID/G-CAP's cooperative agreement with CCAA, we held discussions with USAID/Washington officials and USAID/G-CAP officials.

We performed the following:

- Reviewed relevant laws, regulations, guidance, and procedures to gain an understanding of the compliance issues relating to Section 533 restrictions, obligating appropriated funds, and restrictions on lobbying.
- Interviewed program officials and evaluated the internal control systems for ensuring compliance with Section 533 restrictions, obligating appropriated funds, and lobbying restrictions.
- Examined the cooperative agreement, as well as the recipient's annual plan and monitoring and evaluation plan. We also examined other related documents used by the recipient under the cooperative agreement.

To answer the audit objectives, we set no materiality threshold because such a threshold was not relevant to any of the objectives.

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**Management
Comments**

United States Government
MEMORANDUM

Date: February 4, 2005

To: Nathan Lokos, IG/A/PA

From: Carrie Thompson, Acting Mission Director /s/

Subject: Review and Comment on Audit Report No. 9-596-05-00X-P on USAID/G-CAP Program's Cooperative Agreement with Caribbean-Central American Action (Cooperative Agreement No. 596-A-00-04-00235-00)

This memorandum acknowledges receipt of the Draft Audit Report cited above. USAID/G-CAP has reviewed and agrees with the recommendation therein. As part of the record, USAID/G-CAP requests that the final Audit Report include the actions described below, which USAID/G-CAP will continue to monitor for the duration of the Cooperative Agreement with Caribbean-Central America Action (CCAA).

The actions are as follows:

- 1) CCAA has removed all references to "involving U.S. friends" or "asking for help in the ratification of CAFTA" from the body of the Declaration of Principles (DOP) that CCAA Alliance members sign as part of their commitment. CCAA will request all new CCAA Alliance members to sign the revised version of the DOP.
Status: Complete
- 2) CCAA will send a Clarification Letter to all Alliance members who signed the original DOP stating that the Alliance program supports activities exclusively in the Central American Region and that the program supports activities to implement CAFTA rather than to ratify CAFTA.
Status: February 15, 2005
- 3) USAID/G-CAP will add an On-going Monitoring Clause to CCAA's Monitoring & Evaluation Plan to follow up on any and all information being released to the public. The cognizant technical officer will be responsible for monitoring any and all information being released to the public.
Status: On-going for the duration of the Cooperative Agreement.

We thank you for your responsiveness and cooperation. If you have any further questions, do not hesitate to contact USAID/G-CAP.