OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/EL SALVADOR'S ECONOMIC GROWTH PROGRAM

AUDIT REPORT NO.1-519-07-006-P
MARCH 6, 2007

SAN SALVADOR, EL SALVADOR

Office of Inspector General

March 6, 2007

MEMORANDUM

TO: USAID/El Salvador Director, Deborah Kennedy-Iraheta

FROM: Regional Inspector General/San Salvador, Timothy E. Cox /s/

SUBJECT: Audit of USAID/El Salvador's Economic Growth Program (Report No. 1-519-07-006-P)

This memorandum transmits our final report on the subject audit. We have carefully considered your comments on the draft report and have included your comments in their entirety in Appendix II of this report.

This report contains 12 recommendations intended to improve the implementation of USAID's economic growth activities in El Salvador. Based on your comments and the documentation provided, we consider that final action has been taken on Recommendation No. 12, that management decisions have been reached on Recommendation Nos. 1, 2, 3, 5, 6, 7, 8, 9, and 10. Management decisions for Recommendation Nos. 4 and 11 can be recorded once we and the Mission have agreed on a firm plan of action with timeframes for implementing the recommendations. Determination of final action for Recommendation Nos. 1, 2, 3, 5, 6, 7, 8, 9, and 10 will be made by the Audit Performance and Compliance Division (M/CFO/APC) upon completion of the Mission's planned corrective actions.

I appreciate the cooperation and courtesy extended to my staff during the audit.

U.S. Agency for International Development
Regional Inspector General/San Salvador
Unit 3110; APO, AA 34023
Tel (503) 2228-5457 - Fax (503) 2228-5459

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SUMMARY OF RESULTS

As part of its fiscal year 2007 audit plan, the Regional Inspector General/San Salvador performed this audit to answer the following questions:

- Did USAID/El Salvador's economic growth activities achieve planned results?

- Did USAID/El Salvador's reporting on its economic growth activities provide stakeholders with complete and accurate information on the progress of the activities and the results achieved?

With respect to the first question, USAID/El Salvador's economic growth activities achieved planned results in FY 2005. For FY 2006, the Mission's implementing partners met 14 of 16 targets for which results were available. (See page 8.) Despite these accomplishments, we noted four areas where opportunities existed to improve performance management or program operations. Specifically, several performance targets need to be revised so that they will stay relevant, the economic growth portfolio should be reviewed to better ensure that all of the activities being financed are cost effective, the impact of the tax policy and administration activity can be enhanced, and a manual for issuing awards under a contract should be developed and approved so that USAID can fund additional small and medium enterprises. (See pages 10 to 18.)

With respect to the second question above, USAID/El Salvador's reporting on its economic growth activities did not provide stakeholders with complete and accurate information on the progress of the activities and the results achieved. Information presented in the Annual Report and the Congressional Budget Justification was presented without contextual information that a reader would need to interpret the information correctly. In addition, more needs to be done to verify the quality of data reported by USAID's partners, and site visits were not documented. (See pages 19 to 26.)

Two other matters came to our attention during the course of the audit that require corrective action by USAID/El Salvador. Specifically, obligations to the economic growth SOAG did not comply with forward funding requirements and the cost of equipment for the Superintendency of Competition was not justified. (See pages 26 to 30.)

This report contains the following recommendations for USAID/El Salvador:

- Revise performance targets for the economic growth program as required by ADS 203.3.4.5. (See page 11.)

- Review its economic growth portfolio, using readily available information on economic costs and benefits, and take appropriate action to reduce costs or increase cost efficiency for those activities that it concludes are not cost effective. (See page 14.)

- Develop and make available to Government of El Salvador tax authorities information on tax incidence and compliance rates by taxpayer income level. (See page 16.)

- Obtain evidence that the Government of El Salvador has implemented a program to reduce tax evasion through transfer pricing schemes. (See page 16.)

- Build on its tax administration assistance by developing and implementing a plan to engage the Government of El Salvador at the highest level in a dialogue on its tax structure, possibly including the need for a land or property tax, and drawing on the analytical capabilities of its current contractor or other sources of expertise as necessary. (See page 16.)

- Require Nathan Associates to submit an adequate operating manual to the Contracting Office for approval as soon as possible. (See page 18.)

- Require Aid to Artisans to periodically validate the formulas used to estimate the number of new jobs created, or obtain information on the actual number of new jobs created directly from assisted firms. (See page 23.)

- Implement a system to disclose the use of estimates and present sufficient contextual information to facilitate understanding of its reporting on the economic growth program. (See page 23.)

- Require Cognizant Technical Officers to periodically sample and review their implementing partners' data for completeness, accuracy, and consistency. (See page 24.)

- Require written site visit reports. (See page 26.)

- Reprogram $11 million to program areas where the funds can be used within the current fiscal year. (See page 28.)

- Reprogram for higher priority uses the $119,355 budgeted for equipment for the Superintendency of Competition but not needed as well as the $26,667 that was spent for video conferencing equipment that is not justified. (See page 29.)

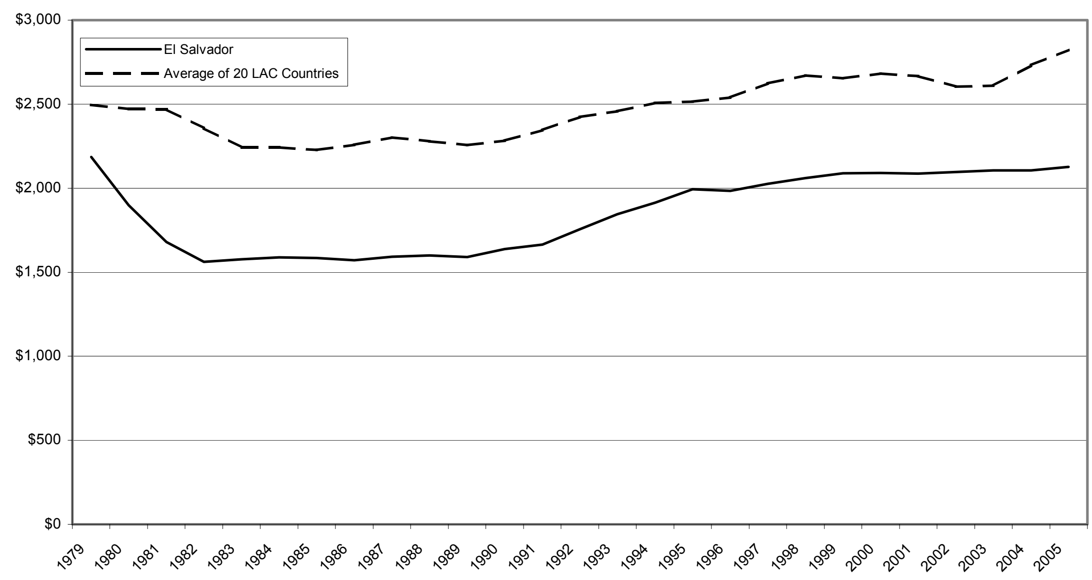
For the most part, USAID/El Salvador concurred with the recommendations included in this report and has agreed to take corrective action. Our evaluation of management comments is provided after each recommendation in the report. USAID/El Salvador's comments in their entirety are included in Appendix II.

BACKGROUND

With the exception of a brief period of rapid growth in the early 1990s, El Salvador's economic performance since 1979 has been poor. Figure 1 below, which covers a period of 26 years, shows that El Salvador's gross domestic product (GDP) fell 28 percent at the outset of the civil war that began in 1979. GDP recovered rapidly during the early 1990s, following the end of the war and the adoption of several major economic reforms, including tariff reductions and tax reform. However, this period of rapid growth was brief, and in 1996 El Salvador entered a period of slow growth that has persisted up to the present time. During the five-year period beginning in 2000, real per capita GDP increased a total of just 1.7 percent.

While economies in the Latin America and Caribbean (LAC) region as a whole have grown slowly since 1979, El Salvador's per capita GDP growth has under performed the rest of the region throughout this period, with the notable exception of the period from 1989 to 1995. In fact, El Salvador's real per capita GDP is only now approaching the levels that were attained before the start of the civil war a quarter of a century ago.

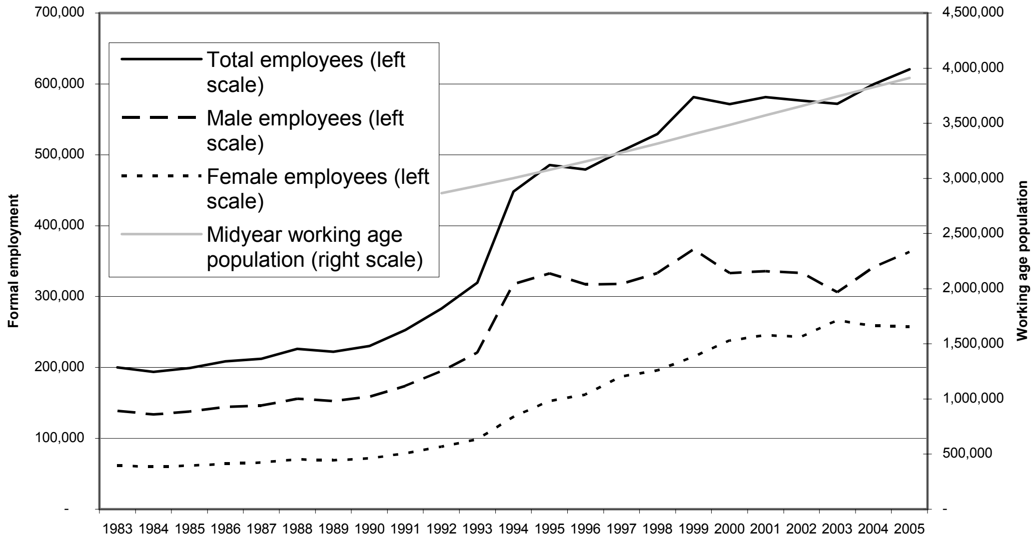
Figure1: Per Capita GDP, Purchasing Power Parity Method, in Constant 2000 Dollars for El Salvador and 20 LAC Countries with Populations over 3 Million.



Source: World Bank, World Development Indicators Online

Turning to the issue of jobs, employment in the formal sector in El Salvador grew rapidly from the end of the war in 1991 through 1995. Since 1995, employment has grown more slowly, just keeping pace with the growth in the population of working age. (Interestingly, from the end of the war until 1995, growth in formal employment was evenly divided between jobs held by men and women; since 1995, 78 percent of the growth has been in jobs held by women.)

Figure 2: Formal Employment (Employees Enrolled in Social Security), 1983 – 2005 and Estimated Working Age Population 1992 – 2005



Sources: Salvadoran Social Security Institute (ISSS) and U.S. Census Bureau International Data Base.

In 2004, USAID/El Salvador estimated that about 31 percent of employed workers were in the formal sector while 19 percent were employed in agriculture and 50 percent were self employed or worked in the informal sector. The Mission estimated that underemployment in agriculture and the informal sector was roughly 30 percent; however, reliable employment and unemployment statistics for these sectors do not exist.

Among the most important reasons for El Salvador's weak economic performance are the following:

- From approximately 1979 to 1991, El Salvador's civil war severely disrupted the economy and destroyed existing political, social, and economic structures.

- Frequent natural disasters (e.g., earthquakes in 1985 and 2001, flooding from Hurricane Mitch in 1998 and Tropical Storm Stan in 2005, and a volcanic eruption in 2005) have disrupted economic activity and destroyed valuable infrastructure.

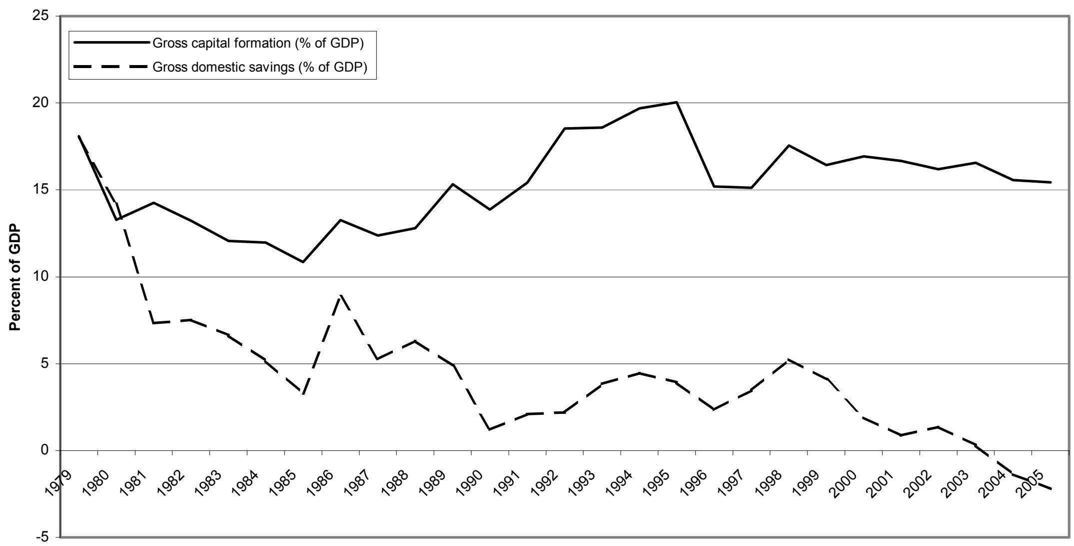
- Relatively easy access to the United States, resulting in high levels of legal and illegal immigration, is thought to attract many of the most ambitious and determined members of the labor force, denying the Salvadoran economy an important source of growth. Remittances sent back home help to increase consumption in El Salvador but probably also reduce incentives to work.

- An extremely serious crime problem has increased the cost of doing business in El Salvador to the point that an estimated 11 percent of GDP now goes to pay for security services. Crime is a critical barrier to increased investment and economic growth.

- External shocks adversely affected economic growth during the first part of the current decade. One researcher has estimated that these shocks, dominated by the effects of the 2001 recession in the United States and the subsequent slow recovery, may have reduced GDP growth in El Salvador roughly 2 percentage points in both 2001 and 2002.[1]

- Gross domestic savings fell throughout the war period, partially recovered through 1998, and have steadily declined since then, finally becoming negative in 2004 and 2005. Gross capital formation, a measure of investment, fell during the early years of the civil war, increased from 1985 to 1995, and has declined fairly steadily since 1995 to its current level of about 15 percent of GDP. These trends are illustrated in Figure 3.

Figure 3: Gross Domestic Savings and Gross Capital Formation, 1979 – 2005



Source: World Bank, World Development Indicators Online.

- Declining productivity has also adversely affected economic growth. Total factor productivity fell an estimated 0.8 percent annually from 1980 through 2004 and labor productivity in 2002 was only about two-thirds of the peak level attained just before the outbreak of the civil war.[2] These trends are thought to reflect low spending on research and development, the absence of linkages between the education and business sectors, and deficiencies in the ability of firm management to innovate, implement improved business processes, and take advantage of the opportunities offered by technological advances and the opening of new markets. Low rates of investment, discussed above, may have also contributed to declines in productivity, to the degree that investment has not been sufficient to take advantage of technical innovations. Finally, it is possible that the evolution of El Salvador's economy from an agriculture-based economy to a service-based economy has not provided the

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[1] Edwards, Sebastian, "The Slowdown of Economic Growth in El Salvador: An Exploratory Analysis," unpublished draft monograph, 2003. The model developed by Edwards produced midpoint estimates of -2.4 percent in 2001 and -1.8 percent in 2002 within ranges of -1.6 to -3.2 percent and -1.2 to -2.4 percent respectively.

[2] International Monetary Fund, "El Salvador: Selected Issues – Background Notes" (IMF Country Report No. 05/270), 2005 and Larrain, Felipe P., "*El Salvador: ¿Cómo Volver a Crecer?*" Interamerican Development Bank, 2003.

same scope for technological innovation that evolution to a manufacturing economy would have provided.

- After a period of rapid reform in the early 1990s, the pace of reform has slowed. Changes to El Salvador's institutions to strengthen the rule of law, better protect property rights, encourage competition, reduce corruption, and ensure government transparency and accountability would encourage faster long-term economic growth.

Along with these challenges that have caused El Salvador to consistently under perform most other LAC countries in terms of economic growth, there are some positive developments and areas of strength. The labor force in El Salvador, with its strong work ethic, is a crucial asset, although there are indications that remittances are eroding this asset. At the macroeconomic level, El Salvador has achieved stable exchange rates and low inflation. El Salvador's currency was pegged to the dollar from 1995 through 2000, and on January 1, 2001, the value of the local currency was fixed by law at 8.75 *colones* per U.S. dollar and the dollar became legal tender.[3] Since 1995, El Salvador's inflation rate has averaged 4.2 percent, or about one-fifth of the average rate for Latin America. The Central American Free Trade Agreement (CAFTA) is expected to boost El Salvador's growth rate, assuming that the country undertakes the reforms and complementary investments needed to take advantage of the opportunities provided by CAFTA. An additional boost will come from the agreement that the Government of El Salvador recently signed with the Millennium Challenge Corporation that will provide $461 million in grant funding over the next five years for road construction and other investments in the Northern part of the country. Finally, the Government has made progress in reducing the red tape associated with starting a new business in El Salvador, and the International Finance Corporation currently estimates that 26 days are required to start a business in El Salvador.

USAID/El Salvador is attempting to address some of the constraints to economic growth in El Salvador through a strategic objective that began in July 2005 and is scheduled to end in September 2009. The strategic objective, its planned intermediate results, the contractors and grantees that are implementing programs under the strategic objective, and the financial status of the programs are outlined in Table 1 below.

Table 1: Strategic Objective, Intermediate Results, and Contractors and Grantees[4] (Financial Information as of September 30, 2006 – Unaudited)

Description	Obligations ($ millions)	Accrued Expenditures ($ millions)
Strategic Objective No. 2: Economic Freedom: Open, Diversified, Expanding Economies		
Intermediate Result No. 1: Laws, Policies, and Regulations that Promote Trade and Investment		
Development Alternatives, Inc. – Provide assistance to the	3.3	1.4

[3] It is important to note that, while dollarization of El Salvador's economy has produced important benefits in terms of stability and low inflation, it precludes the use of monetary policy to manage the economy. In particular, since El Salvador cannot adjust its exchange rate, at least in the short term, any threats to competitiveness must be addressed by increasing productivity, something that the country has so far been unable to do.

[4] This table excludes watershed management activities and USAID monitoring and evaluation expenses, which were not included in the audit scope.

Description	Obligations ($ millions)	Accrued Expenditures ($ millions)
GOES in tax administration.		
Booz Allen Hamilton – Provide assistance to the GOES Superintendency of Competition on enforcement of a new competition law, assistance to GOES customs authorities on CAFTA implementation, and assistance to the Technical Secretariat of the Presidency of El Salvador on reducing the cost and time required to register and close private businesses.	2.6	0.1
Fintrac – Help the Ministry of Agriculture regulate pesticide use.	0.9	0.8
Miscellaneous	0.5	0.5
Subtotal	*7.3*	*2.7*
Intermediate Result No. 2: More Competitive, Market-Oriented Private Enterprises		
Fintrac – Provide assistance in improved field production techniques and processing methods and promote investment in rural areas.	4.8	2.2
Aid to Artisans – Provide assistance in production and marketing of crafts.	1.8	1.1
Nathan and Associates – Provide technical assistance to strengthen the competitiveness of small and medium enterprises.	7.9	5.8
Chemonics – Provide assistance to the specialty coffee and sanitary and phytosanitary standards (SPS) activities	1.2	1.0
World Environmental Center – Help 33 Salvadoran businesses improve energy efficiency.	0.6	0.2
Direct USAID/El Salvador grants to 18 Salvadoran entities for community infrastructure (e.g., roads, bridges, schools, and water systems).	0.7	0.6
Subtotal	*17.0*	*11.1*
Intermediate Result No. 3:Broader Access to Financial Markets and Services		
Chemonics – Help financial institutions expand lending to SMEs.	2.6	0.9
Development Alternatives, Inc. – Help strengthen microfinance institutions.	1.0	0.8
Loan guarantee funded under USAID's Development Credit Authority to encourage lending to SMEs.	0.3	0.1
Subtotal	*3.9*	*1.8*
Total	*28.2*	*15.6*

AUDIT OBJECTIVES

As part of its fiscal year 2007 audit plan, the Regional Inspector General/San Salvador performed this audit to answer the following questions:

- Did USAID/El Salvador's economic growth activities achieve planned results?
- Did USAID/El Salvador's reporting on its economic growth activities provide stakeholders with complete and accurate information on the progress of the activities and the results achieved?

Appendix I contains a discussion of the audit's scope and methodology.

AUDIT FINDINGS

Did USAID/El Salvador's economic growth activities achieve planned results?

USAID/El Salvador's economic growth activities achieved planned results in FY 2005. For FY 2006, the Mission's implementing partners met all but two of its targets for which results were available. Out of the 19 activity-level indicators listed in its Performance Management Plan (PMP), performance targets for 14 indicators were met and targets for 2 indicators were not met (final results for one indicator were not available [1a], results for another indicator could not be compared to its target [3d], and one indicator was not expected to produce results until FY 2007 [2d]).

Table 2: 19 Economic Growth Activity-Level Indicators and Their Corresponding Targets and Results for FYs 2005 and 2006

Performance Indicator	Target for FY 2005	Actual for FY 2005	Target for FY 2006	Actual for FY 2006
1a. Avg # of hours for clearance and release of goods in customs	Not shown	30	28	Not available
1b. Total tax collection as % of GDP*	13.0%	13.2%	13.4%	Est.13.6%*
1c. # of people trained for CAFTA implementation	No result expected	No result expected	25	0
1d. Total # of days to register a new business	Not shown	40	35	26
2a. Increased annual sales by SMEs**	$4.2 million	$10.2 million	$19.3 million	$32.4 million
2b. Increased annual exports of SMEs**	$2.8 million	$9.1 million	$14.9 million	$28.2 million
2c. New jobs created by SMEs**	800	2,621	3,400	3,956
2d. Economic savings on industries as a result of cleaner production/energy efficiency measures	No result expected	No result expected	No result expected	No result expected
2e. Number of people trained by business development programs**	675	2,692	3,200	4,805
2f. Cumulative # of SMEs assisted to strengthen competitiveness**	485	566	1,235	2,075
2g. # of enterprises participating in a clean production program	No result expected	No result expected	18	14
2h. # of community identified infrastructure activities completed through community participation	Not shown	13	10	10
3a. # of active new SME borrowers	No result expected	No result expected	150	446
3b. # of active new loans to SMEs	No result expected	No result expected	200	1,816

Performance Indicator	Target for FY 2005	Actual for FY 2005	Target for FY 2006	Actual for FY 2006
3c. Total value of active new loans to SMEs	No result expected	No result expected	$1 million	$52.3 million
3d. Delinquency rate of assisted regulated financial institutions	No result expected	No result expected	0.25% less than 2005	1.15%
3e. # of people trained under financial services program	No result expected	No result expected	200	269
3f. # of active new borrowers of assisted microfinance institutions	No result expected	No result expected	1,200	3,761
3g. Total # of active new loans by assisted microfinance institutions	No result expected	No result expected	1,320	3,885
* This indicator actually measures calendar year results, but the 13.6% result is a preliminary estimate for the period from January through September 2006. ** FY 2005 targets and results for these indicators included the period under the new strategy from July to September 2005. In addition, the reported number of jobs was based on estimates.				

As indicated above, two FY 2006 results were not met. First, the Mission did not train 25 people for Central American Free Trade Agreement implementation because the trade policy activity started on July 10, 2006, almost four months later than originally planned. The delay occurred because the process for reviewing and selecting the best proposal took longer than anticipated. USAID requested clarifications and broader explanations from some of the contractors who participated in the competition and negotiations with the selected partner took longer than expected. A USAID official noted that it would be very easy to train 25 people during 2007. Second, the cleaner production activity did not assist 18 companies as intended. As of September 30, 2006, it had assisted 14 companies. The strategy was to work with two large companies and their supplying companies to improve environmental standards and create savings. The activity initially attracted one large company but experienced difficulty in attracting a second large company. Subsequent to the end of the fiscal year, two other large companies have agreed to participate in the activity and meeting this target will not be a problem in the future. We believe that both activities described above will reach their life of activity targets and therefore, we are not making a recommendation on these matters.

As can be seen above, the Mission has achieved successes in several program areas including tax collections, firms made more competitive, and people trained. Examples of other achievements, beyond the statistics presented above, follow:

- Laws, Policies and Regulations that Promote Trade and Investment – In addition to increasing tax collections, USAID has trained tax auditors and supervisors and has assisted the Ministry of Finance in automating collection processes.

- More Competitive, Market-Oriented Private Enterprises – Under the agricultural diversification activity, USAID introduced new profit and productivity enhancing technologies to the Salvadoran horticulture sector. Farmers, processors, and agricultural service providers have benefited from the introduction of high-value crop production using sustainable new technologies that have increased yields and incomes. Average annual client gross income for drip irrigated field clients increased from $1,222 per manzana to $10,342 per manzana or 758 percent (1 manzana = 1.73 acres). Under the export promotion activity, USAID has been successful in helping small and medium enterprises (SMEs) by forming trading groups, assisting industry associations, organizing buying missions, and participating in trade fairs. Under its small infrastructure activity, nine roads and one irrigation system have been constructed during FY 2006, benefiting 23,067 people. The irrigation system will allow farmers to harvest crops during the dry season. Community leaders stated that one new road has led to a reduction in the cost of transporting crops from $16 to $6 per trip. New businesses have also been established in the communities surrounding the new road.

- Broader Access to Financial Markets and Services – USAID has been successful in training participating financial institutions to better understand how to work with SMEs and to better understand the importance of SMEs in fostering economic growth in El Salvador.

Despite these accomplishments, we noted four areas where opportunities existed to improve performance management or program operations. More specifically, several performance targets should be revised so that they will stay relevant, the economic growth portfolio should be reviewed to reduce costs or increase efficiency for activities that are not cost effective, the impact of the tax policy and administration activity can be enhanced, and a manual for issuing awards under a contract should be developed and approved so that USAID can fund additional SMEs. These areas are discussed in the following sections.

Performance Targets Were Too Conservative

Summary: ADS 203.3.4.5 states that USAID should set performance targets that can optimistically but realistically be achieved. Over half of the targets in the Performance Management Plan were set too conservatively and were easily surpassed. The Mission was unable to establish more precise targets because this was the first year of implementation under the new strategy and four of the six key economic growth awards had not yet been made. Making targets more challenging will help keep the targets relevant and may help encourage improved results.

According to ADS 203.3.4.5, USAID operating units should set performance targets that can optimistically but realistically be achieved within the stated timeframe and with the available resources. Targets should be ambitious but achievable given USAID and other donor inputs. Ten of the 19 FY 2006 targets for activity-level indicators listed in the Performance Management Plan were set too conservatively and were surpassed by a large margin. Some examples of overly conservative targets follow:

- Results for the financial services activity greatly exceeded six financial services targets because, at the time targets were established, not all of the implementing partners had been selected and the number of participating financial institutions was still unknown. As a result, the target of 200 new loans for FY 2006 was far below the actual result of 1,816, representing a value of $52.3 million instead of $1 million. As another example, the target of 150 new borrowers was much lower than the actual result of 446 borrowers.

- USAID/El Salvador planned to increase FY 2006 annual sales by assisted SMEs by

$19.3 million. Its implementing partners greatly surpassed this target, increasing sales by $32.4 million because it included $13 million in sales generated by firms that only received training for the first time. Previously, under the export promotion activity, only sales from firms that received some type of technical assistance other than training were included. Because the methodology for counting sales has changed, the targets need to be increased.

- Actual FY 2006 results of 4,805 people trained by business development programs far exceeded the target of 3,200. The Cognizant Technical Officer (CTO) for the agricultural diversification activity underestimated the number of people that were to be trained.

- USAID/El Salvador's contractor for the tax policy and administration program estimates that the Government of El Salvador (GOES) will achieve tax collections of 14 percent of gross domestic product (GDP) in 2006 versus the USAID target of 13.4 percent. Given this performance, which exceeded expectations, the USAID target for 2007 of 13.7 percent will likely be met earlier than planned and should be increased. The USAID end-of-project target of 14.5 percent by 2009 should also be increased, given that the GOES target is 15.2 percent by 2009 and that USAID's contractor believes that a target of 16 percent would be attainable.

- Under the trade policy activity, the work plan for the year ending August 30, 2007 listed a target for the average number of hours for clearance and release of goods in customs as "less than 48 hours". However, at the end of FY 2005 goods were already being cleared from customs in 30 hours. The USAID CTO believed that the work plan used a target that was established before actual FY 2005 results were available. He agreed that this target should be updated.

Targets for the remaining three years of the strategy should be revised so that they are more challenging to achieve, yet realistic. The targets were not established at a level that was challenging to achieve because USAID relied on preliminary estimates at the outset of its economic growth program. Only four of the six main economic growth awards had been issued when the targets were established in November 2005. USAID is now in a position to supplement its initial estimates with more recent information based on actual performance for FY 2006.

Targets that are set too low are not useful for management and reporting purposes. Increasing targets will help keep the targets relevant and may help encourage improved results.

Recommendation No. 1: We recommend that USAID/El Salvador revise its performance targets for the economic growth program as required by ADS 203.3.4.5.

Evaluation of Management Comments – In response to our draft report, USAID/El Salvador stated that performance targets for fiscal years 2007, 2008, and 2009 will be revised as required by ADS 203.3.4.5.

Based on the information provided by USAID/El Salvador, we consider that a management decision has been reached for Recommendation No. 1. Determination of final action for this recommendation will be made by the Audit Performance and Compliance Division (M/CFO/APC).

An Economic Analysis Would Have Been Useful

Summary: ADS Chapter 201 states that an economic analysis should be performed when an operating unit concludes that one is needed. While USAID/El Salvador followed a defensible process in developing economic growth activities, the process would have been strengthened by an economic analysis which would have helped quantify costs and benefits and make them more readily comparable. As a result of not arranging for an economic analysis, USAID/El Salvador did not have reasonable assurance that all of its economic growth activities were those that would have the greatest economic impact. In fact, based on a cursory examination of cost and sales information, one activity – the Artisan Development Activity – did not appear to be cost beneficial. An economic analysis was not performed because there was little support in the mission for performing such an analysis, especially in light of other demands on staff time.

ADS Chapter 201 describes the requirements for activity design and analysis. The ADS notes that much of the analytical work needed to plan activities is normally conducted as part of preparing strategic plans. USAID operating units should conduct those analyses that they conclude are needed to plan detailed and rigorous activities to achieve the intended results. Among the types of analysis that may be conducted is an economic analysis, which helps determine whether a particular development program or activity is a worthwhile investment for the country being assisted.

According to the "additional help" document referenced in ADS Chapter 201 entitled "Economic Analysis of Assistance Activities," the purpose of economic analysis is to determine whether an activity is a worthwhile investment for the country, i.e., whether the results from an activity are sufficiently valuable as to warrant the expenditure of scare resources. Economic analysis also allows activity designers to select the least-cost design from among alternatives, as well as to choose among alternative activities in the same sector or in different sectors. Where results are easily evaluated in monetary terms, an economic analysis provides one measure by which to evaluate and compare possible interventions. Where results are quantifiable but not easily reduced to monetary values, economic analysis allows the designer to determine the real cost per unit output, which is indispensable in making judgments concerning an activity's value. Where outputs are not readily quantifiable, economic analysis enables choice between competing designs on a least-cost basis.

USAID/El Salvador followed a defensible process in designing its economic growth activities, but an economic analysis would have strengthened the process. The design process included a consideration of assessments prepared by several consultants and experts and wide consultation with GOES counterparts, NGOs, private companies, and other donors. After sifting the information it received from others, USAID/El Salvador made financing decisions that reflected the priorities established by USAID and State Department leadership and USAID/El Salvador's economic growth strategy, judgments about its own experience and expertise relative to those of other parties involved in supporting economic growth in El Salvador, and the availability of qualified partners to implement specific types of activities.

An economic analysis could have added rigor to this prioritization and decision-making process by providing quantified and largely objective information on the costs and benefits of proposed activities. Performing an economic analysis does not eliminate all subjectivity from the activity selection process but it does add discipline and structure to the process, largely by expressing costs and benefits in common monetary terms that facilitate comparison of alternative activities and implementation methods.

In the absence of an economic analysis, in our opinion, USAID/El Salvador was not reasonably assured that all of the activities it was financing were those that would have the greatest impact in terms of contributing to transformational development. This is not to say that the activities USAID/El Salvador is financing are not worthwhile or not valuable to the beneficiaries. Rather, our point is that there is not a strong analytical basis for concluding that USAID/El Salvador is financing the *most* worthwhile activities.

While we did not ourselves attempt any economic analysis of the activities supported by USAID/El Salvador, a cursory examination of readily available information indicates that at least one of the activities – the Artisan Development Activity – may not produce economic benefits that justify the cost of the activity. Over the life of the activity from June 2002 through June 2009, program costs are expected to total $6.2 million while increased sales due to the activity are expected to total only about $5.7 million, or 92 percent of program costs.[5] Even if sales could be taken to represent net benefits to El Salvador – and we believe that they actually overstate them since opportunity costs would need to be deducted to determine net benefits – this does not appear to represent a cost effective use of USAID funds.[6]

USAID/El Salvador did not arrange for an economic analysis of the activities included in its economic growth program for at least two reasons. First, in our opinion, since USAID's activity development procedures were modified in the mid-1990s to make economic analysis optional, economic analysis has become almost vanishingly rare within USAID. We are sympathetic, in theory, to the proposition that economic analysis should be performed only when it is useful, and that USAID operating units should be empowered to decide when in fact it would be useful. Unfortunately, in practice, many USAID employees would say that they are responsible for accomplishing more than they actually have time to accomplish, and under these circumstances it is unrealistic to imagine that they will elect to take on optional analyses which are difficult and time consuming. Second, at least one USAID/El Salvador official is of the opinion that it is

[5] As of September 30, 2006, cumulative sales were $2.5 million and cumulative USAID costs (i.e., excluding cost sharing contributions) were $3.3 million. (USAID's partner plans to help establish a local organization to sustain the program after the end of USAID funding and has projected that sales during the first three years after the end of USAID funding could total $3.1 million. However, there is no estimate of the costs that would be incurred during this period.)

[6] It may be relevant to state here that some other activities financed under the economic growth program are expected to produce substantially higher returns although, again, we did not attempt any type of economic analysis. For example, under the export promotion activity the contractor expects to generate increased sales about five times greater than program costs, and the agricultural development activity has reported increased sales of about three times program costs.

too difficult to project economic benefits with enough precision to make economic analysis valuable. We would have to disagree with this position, and we continue to regard economic analysis as a best practice, especially for large programs like the economic growth program where USAID anticipates a total investment of $70 million, and especially in fields of endeavor like the economic growth field, where it is relatively easy to express costs and benefits in monetary terms.

While we are not recommending that USAID/El Salvador perform an economic analysis at this late stage, when activities are already underway, we do think it would be useful for USAID/El Salvador to at least review its economic growth activities and consider how likely it is that they will produce benefits that justify their costs. For activities like the Artisan Development Activity, where readily available information indicates that the activity is not cost effective, the Mission should take corrective action or to increase cost efficiency, perhaps after undertaking additional analysis.

> *Recommendation No. 2: We recommend that USAID/El Salvador review its economic growth portfolio, using readily available information on economic costs and benefits, and take appropriate action to reduce costs or increase cost efficiency for those activities that it concludes are not cost effective.*

Evaluation of Management Comments – In response to our draft report, USAID/El Salvador stated that it will develop a matrix with calculations of expected, direct financial costs to be incurred by USAID and its partners and contrast these costs to the expected, direct financial benefits during and after the activity period. For those activities not deemed cost effective, this analysis will be used as a basis for appropriate action by USAID managers.

Based on the information provided by USAID/El Salvador, a management decision has been reached for Recommendation No. 2. Determination of final action for this recommendation will be made by the Audit Performance and Compliance Division (M/CFO/APC).

The Tax Policy and Administration Program Can Be Enhanced

Summary: The audit identified opportunities to enhance the effectiveness of the tax policy and administration program by (1) developing information on the incidence of taxes and compliance rates by income level, (2) developing an enforcement program that focuses on transfer pricing schemes, and (3) moving beyond tax administration issues to open a dialogue with the GOES on its tax structure. Details on each of these three areas are discussed below.

USAID/El Salvador's assistance in tax policy and administration has a long record of accomplishment dating back to 1991. During two earlier assistance programs, for example, USAID helped the GOES increase tax revenues as a percentage of GDP from 8 percent in 1990 to 12 percent in 1995 and from 11 percent in 2001 to 13 percent in 2005. The current program, which began in August 2005, is designed to build on these earlier successes by helping the GOES further improve tax administration and, if deemed necessary, by helping analyze and draft proposed changes to the tax structure itself. During our audit, we noted opportunities to enhance the impact of the program by taking actions in the three areas discussed below.

Incidence of Taxes and Compliance Rates by Income Level – Information on the incidence of taxes by income level – that is, the degree to which existing taxes fall on low income and higher income taxpayers – is among the most basic information needed to assess the effect of taxes on economic activity and to make judgments about the fairness of a tax system. Information on compliance rates by income level is needed to help focus enforcement programs and, again, inform judgments about fairness. To date, no such information has been developed, although officials working on the tax policy and administration program agreed that it would be useful. This information has not been gathered, among other reasons, because the program only recently got underway and attention was focused on other priorities. As a result, information that is needed to make tax policy and enforcement decisions is not available to decision makers in the GOES.

Transfer Pricing Schemes – USAID's contractor for the tax policy and administration program has urged the GOES to develop an enforcement program focused on transfer pricing schemes in which corporations and wealthy individuals fraudulently transfer income from El Salvador to overseas tax havens by paying for goods and services that are overpriced or not delivered at all. The contractor estimates that one-quarter of all income tax evasion in El Salvador takes place through such transfer pricing schemes.

To date, the GOES has been reluctant to focus enforcement efforts on these schemes, citing concerns about El Salvador's competitiveness. It is difficult to believe that any country would choose to compete with others on the basis of lax tax law enforcement, but in any event, according to USAID's contractor, El Salvador's neighbors are all making progress in combating transfer pricing schemes, so concerns about competitiveness are a chimera.

Reducing tax evasion through transfer pricing schemes could make available immense new revenues to the GOES. For example, reducing tax losses from transfer pricing schemes by one half could increase tax revenues by roughly $150 million annually.[7]

Tax Structure – Several authorities, taking note of the imbalance between the demands placed on the GOES and its tax revenues, have suggested that changes to the tax structure may be needed. Such changes might well include establishment of a land or property tax. For example, the International Monetary Fund (IMF) has urged the GOES to consider additional tax measures to complement its efforts to reduce tax evasion, and a 2002 IMF working paper pointed out that property taxes were very low throughout Central America and concluded that "property taxation is an under-used source of revenue and should also be strengthened …"[8] Several consultants that contributed to the design of USAID/El Salvador's economic growth program reached similar conclusions, with one contractor concluding that a property tax "is one obvious area

[7] This estimate is based on estimates by USAID's contractor that the income tax evasion rate is 59 percent and that 25 percent of income tax evasion is due to transfer pricing schemes.

[8] International Monetary Fund, "IMF Executive Board Concludes 2006 Article IV Consultation with El Salvador" (Pubic Information Notice No. 06/84), July 31, 2006 and Stotsky, Janet and Asegedech WoldeMariam, "Central American Tax Reform: Trends and Possibilities," (IMF Working Paper No. WP/02/227), December 2002.

where additional revenues might be sought."[9] Finally, U.S. Embassy officials in El Salvador have drawn a relationship between the level of available resources and the ability of the GOES to deal effectively with crime and other challenges, and have suggested that the time might be right to examine the tax structure including the need for a property tax.

We believe that it is important to open a dialogue with the GOES on the tax structure, perhaps including a discussion of the merits of a land or property tax. Currently, there is no universal property tax in El Salvador, although some municipalities impose modest charges based on formulas that generally do not correspond closely to property values, such as the number of linear meters of street frontage of a property.

A land or property tax could increase revenues substantially and permit government institutions to govern more effectively. If these revenues accrue to local governments, a property tax would support USAID/El Salvador's governance strategy, which is based on the premise that governance is strengthened when fiscal and other authorities are decentralized to the local level, where citizen oversight of government actions is thought to be more effective. Finally, a well-designed land or property tax could encourage more productive use of land, which is a scarce resource in El Salvador.

Discussions with the GOES have not yet taken this direction because the tax policy and administration program is heavily focused on tax administration rather than reform of the existing tax structure. (However, the task order with USAID's contractor indicates that, if deemed essential, the contractor may assist with reform of the tax structure itself.) No discussions with the GOES on a possible property tax have been held because property taxes are often considered to be in the domain of local governments and the contractor is working with the Ministry of Finance, a national level institution.

* * *

To help the tax policy and administration program build on previous successes and enhance the program's effectiveness in the three areas outlined above, we offer the following recommendations:

> *Recommendation No. 3: We recommend that USAID/El Salvador, working through its contractor, develop and make available to Government of El Salvador tax authorities information on tax incidence and compliance rates by taxpayer income level.*
>
> *Recommendation No. 4: We recommend that USAID/El Salvador work with the Government of El Salvador to implement a program to reduce tax evasion through transfer pricing schemes and obtain evidence that such a program has been implemented.*
>
> *Recommendation No. 5: We recommend that USAID/El Salvador build on its tax administration assistance by developing and implementing a plan to engage the Government of El Salvador at the highest level in a dialogue on its tax structure, possibly including the need for a land or property tax, and drawing on the*

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[9] Carana Corporation, "Economic Growth Strategy for USAID/El Salvador: Final Synthesis Report," April 6, 2004.

analytical capabilities of its current contractor or other sources of expertise as necessary.

Evaluation of Management Comments – In response to Recommendation No. 3 of our draft report, USAID/El Salvador stated that it will ensure that its contractor works with the GOES database and Ministry of Finance personnel to carry out an analysis of tax incidence and compliance rates by income level. With regard to Recommendation No. 4, it will provide specialized training on transfer pricing and work with the Tax Investigation Unit to develop a set of written investigation guidelines for transfer pricing. Concerning Recommendation No. 5, it will initiate a comprehensive study of the El Salvador tax system, including opportunities for reform, and plans to share and discuss this report with high-level government officials.[10]

Based on the information provided by USAID/El Salvador, we consider that a management decision has been reached for Recommendation Nos. 3 and 5. Determination of final action for these recommendations will be made by the Audit Performance and Compliance Division (M/CFO/APC).

For Recommendation No. 4, we believe that USAID/El Salvador's proposed actions are constructive but do not fully satisfy the intent of the recommendation since they focus on inputs rather than results. In addition to financing training and guidelines for investigating fraudulent transfer pricing schemes, we believe that USAID/El Salvador should approach GOES policymaking officials to persuade them to implement an enforcement program focused on transfer pricing schemes. (If USAID/El Salvador exerts its best efforts at the appropriate level but is unsuccessful, then we may close the recommendation on the basis that it is impractical to implement the recommendation. Again, though, we think that the case for implementing an enforcement program focused on transfer pricing is compelling.)

A Portion of the Export Promotion Activity Was Delayed

Summary: A portion of an activity designed to help small and medium enterprises increase exports has been delayed for five months because USAID/El Salvador has not yet approved the operating manual to be used by its implementing partner to provide technical assistance, invitational travel, and other services. The delay occurred mainly because the draft manuals submitted by USAID's partner were incomplete. As a result of not having an approved manual, USAID missed the opportunity to fund an estimated 23 small and medium enterprises. USAID's approval of the manual is needed because USAID must ensure that the requirements that apply to its grants also apply to grants that a USAID partner executes.

[10] USAID/El Salvador also expressed the opinion that these recommendations went beyond the audit objective of determining whether activities achieved planned results. We are concerned that too narrow an interpretation of our audit objective could lead to a program results audit that includes nothing more than an uninteresting and mechanical comparison of planned and actual results. We interpreted our audit objective less narrowly, allowing room for recommendations to improve program outcomes.

USAID has not been able to help several SMEs to increase exports for the past five months as anticipated due to delays in approving the operating manual for the export development fund managed by Fomento a las Exportaciones (FOEX), an operating unit within the Ministry of Economy. Through FOEX and USAID's implementing partner, USAID provides 50-50 co-financing of technical assistance, invitational travel, and other services for individual enterprises or associative groups, up to a maximum amount of US $25,000. USAID intends to provide up to $1,250,000 for the fund, with $424,210 budgeted for the activity's first year ending on March 31, 2007. In July 2006, USAID's implementing partner approved three firms for a total of $50,000 through the fund. Shortly thereafter, USAID's partner decided to postpone the distribution of funds through FOEX based on a warning by USAID's contracting office. USAID suggested that the partner discontinue the issuance of additional funds to SMEs in the absence of an approved operating manual.

In our opinion, the delay occurred mainly because the draft manuals submitted by the partner to USAID/El Salvador were incomplete. The USAID Contracting Officer stated that four drafts have already been reviewed and determined to be unacceptable. While they may have been acceptable from a technical point of view, they did not address what controls will be in place to ensure that funds will be distributed in accordance with USAID regulations. The manuals did not clearly explain what types of awards will be used (grants and/or purchase orders; fixed price and/or reimbursable).

A financial analyst working for the implementing partner estimated that, as a result of the delay in agreeing on the procedures to be used, USAID and its partner have missed the opportunity to assist about 23 firms, which also represents missed opportunities for additional export sales and job growth. This estimate is based on the activity's prior experience of approving 4.5 companies per month for the five months between August and December 2006.

ADS 302.3.4.8 specifically states that grants may be awarded under contracts only after "the Head of the Contracting Activity provides written approval … USAID must ensure that the requirements that apply to USAID-executed grants will also apply to grants that a USAID contractor executes." In other words, as explained by a Contracting Officer, the Mission Director should approve the funding of SMEs through FOEX in a memo prepared by the Cognizant Technical Officer.

> *Recommendation No. 6: We recommend that USAID/El Salvador obtain from the implementing partner of the export promotion activity an adequate operating manual for approval by the Contracting Office as soon as possible.*

Evaluation of Management Comments – In response to our draft report, USAID/El Salvador reiterated that it has made several requests for an operating manual that complies with USAID rules and regulations. The latest version is being reviewed by the Contracts Office and should be approved shortly.

Based on the information provided by USAID/El Salvador, a management decision has been reached for Recommendation No. 6. Determination of final action for this recommendation will be made by the Audit Performance and Compliance Division (M/CFO/APC).

Did USAID/El Salvador's reporting on its economic growth activities provide stakeholders with complete and accurate information on the progress of the activities and the results achieved?

USAID/El Salvador's reporting on its economic growth activities did not provide stakeholders with complete and accurate information on the progress of the activities and the results achieved. Information presented in the Annual Report and the Congressional Budget Justification was presented without contextual information that a reader would need to interpret the information correctly. In addition, more needs to be done to verify the quality of data reported by USAID's partners and site visits were not documented. These areas are discussed in the following sections.

Mission Reporting Lacked Needed Context

Summary: USAID Annual Reports and Congressional Budget Justifications inform decisions about the success of USAID's programs and the level of resources needed to implement the programs. Given their importance, the information presented in these documents needs to be complete and accurate. However, some of the Mission's reporting on its economic growth program could leave readers with incorrect impressions of the results achieved under the program because needed contextual information was omitted. This occurred for several reasons. For example, the Mission staff that prepared reports on the economic growth program were intimately familiar with the program and were susceptible to the mistake of assuming too much knowledge on the part of their readers. As another example, Mission staff wanted to leave a positive impression of their programs and this may have led them to emphasize positive developments. As a result, there was a risk that readers might reach erroneous conclusions about the progress of the economic growth program and the challenges that remain.

ADS 203.3.8.1 states that "the Annual Report is the Agency's principal tool for assessing program performance on an annual basis and communicating performance information to higher management levels and external audiences such as Congress and the Office of Management and Budget (OMB)." The Annual Report Guidance provided by USAID/Washington adds that the Annual Report is "used to collect and analyze program and resource information for a variety of purposes, including the Congressional Budget Justification (CBJ), the Agency's Performance and Accountability Report (PAR), and the Annual Budget Submission (ABS) ... The Annual Report application has become the Agency's primary program reporting document; it is critically important for a number of budget and performance reporting requirements." Since Annual Reports and Congressional Budget Justifications may be used to make decisions about the success of USAID's programs and the level of resources needed to implement the programs, it is vitally important to present complete and accurate information in these documents.

However, there were cases where information that would be needed to correctly understand the progress of the economic growth program and its results was not reported. Some examples follow:

- USAID/El Salvador's Annual Report noted that 1,855 new jobs were created under its artisan development activity. This was in fact an estimate of the number of part-time jobs created under the activity. The estimate was developed from sales figures, by making assumptions about the quantity of labor needed to generate a given amount of sales. (We noted that the partner implementing this activity has not recently evaluated the reasonableness of these assumptions.) The precision of the reported figure, combined with the fact that the Mission did not disclose that the figure was an estimate or that the figure represented part-time jobs, could leave readers with an incorrect impression.

- The Annual Report reported that 429 new jobs were created under the agricultural diversification activity. This figure is based on a series of estimates based on the land area and specific crops cultivated with assistance from USAID's contractor. For example, to estimate the number of jobs created in the coffee sector, USAID's contractor utilizes research done by PROCAFE and obtains tables of the number of labor days that are required per 100 lb. bag of regular coffee and specialty coffee. From the table, the contractor calculates the incremental amount of labor used when a farmer switches from regular coffee to specialty coffee. According to the Coffee Council, 250 labor days equals one permanent job. Therefore, in order to calculate jobs created, the contractor adds up all the incremental labor days created and divides the result by 250. Again, reporting a less precise figure and indicating that it is an estimate would better ensure that readers do not reach unwarranted conclusions.

- In the FY 2007 Mission Performance Plan, USAID/El Salvador reported that the program had increased export and domestic agricultural and SME sales by $26.35 million. However, the actual increase was $28.6 million. Mission staff explained that they had relied on estimates to report increased sales.

- In the Annual Report, the Mission reported that 633 new jobs had been created between October 1, 2004 and June 30, 2005 under its export promotion activity, but the correct figure was 1,162. The number of jobs created was understated because USAID relied on an estimate and did not take into account the results from a survey performed by a research firm.

- The Annual Report reported that "USAID support led to a 120% increase in export and domestic sales, to $16.1 million … USAID assistance directly led to an increase in sales by Salvadoran firms of $10.2 million..." These two statements may be confusing because the reader may incorrectly believe that the $10.2 million figure is included in the $16.1 million figure. In fact, they are additional sales. Another problem with this passage is that the $16.1 million increase in export and domestic sales is not a 120 percent increase in sales, as implied, but rather an increase of 120 percent over the performance target.

- In general, where increased sales, new jobs, or the number of businesses assisted are cited by the Mission, it is difficult to judge the significance of the accomplishments because no context is provided. For example, when a reader reads that $10.2 million in sales were generated in FY 2005, it would also be helpful to know how this relates to the pre-existing level of sales: that is, it would be useful to know the percentage increase in sales.

- In its Annual Report, USAID/El Salvador reported that "over 47,800 new rural clients have access to financial services." This statement could leave an incorrect impression because this is the number of new clients since the Mission began its financial services activities several years ago. The Annual Report is designed to report achievements during a single fiscal year.

- The Mission's Annual Report stated that "distribution of income remains inequitable, with the poorest 20% receiving only 3.4% of national income … Poverty rates are close to 44% in the rural areas." The significance of these statistics is difficult to appreciate without any comparative information from past years or from other countries.

- The Annual Report had two sections, one which covered results under the old strategy from October 1, 2004 to June 30, 2005, and a second which described results under the current strategy which began on July 1, 2005. Since many of the same indicators are described in both sections, without any explanation, a reader may easily become confused. For example, the Mission reported $842,751 in sales and 1,603 new jobs from artisan development activities in the first section and $150,000 in sales and 252 new jobs in the second section. In our opinion, most readers would not understand why two sets of different figures were reported.

- The Annual Report stated that the "economy is expected to grow at approximately 2.5%, exceeding expectations." In this passage, USAID/El Salvador reported a projection of GDP growth but did not report expected population growth, which the U.S. Census Bureau's International Database has estimated at 2.2 percent for 2005. Without this contextual information, a reader would likely reach a positive conclusion about the progress of El Salvador's economy. With this contextual information, the reader would likely reach a more neutral or even negative conclusion: namely, that El Salvador's economy is not growing fast enough to leave its citizens materially better off.[11]

- The Annual Report reported that "the administration … continues to emphasize its commitment to trade-led growth and competitiveness, increased security, transparent and responsible government, job creation and increased social investment. Progress is being made in most areas with the exception of security." This excerpt conveys a positive impression of the GOES' reform efforts, but other authorities have offered more balanced assessments. For example, the World Bank wrote that:

  > El Salvador has achieved considerable progress in the institutional and governance front over the past decade. However, serious deficiencies still exist, particularly in the rule of law and personal security front, as evidenced by corruption, violence and crime indicators. Weaknesses in the rule of law are part of the reason for the apparent low growth yield of reforms in El Salvador in recent years.[12]

  As another example, an academic researcher wrote that:

[11] In the event, El Salvador's economy grew faster than USAID/El Salvador expected – 2.9 percent versus the expected 2.5 percent – so real per capita GDP increased about 0.7 percent.
[12] World Bank, Country Assistance Strategy for the Republic of El Salvador, April 20, 2005.

> Possibly a poor institutional infrastructure – including the perception of a low regard for the rule of law, lack of accountability, an inefficient judiciary, limited respect for property rights and [a] high level of corruption – has been the greatest impediment to increasing investment.[13]

Other authorities have provided even more negative assessments. Presenting a more balanced assessment could have helped readers reach more realistic, nuanced conclusions about the policy environment for economic growth in El Salvador.

- The Annual Report adds that "USAID continues to play a role in this economic transformation, with activities that have increased the competitiveness and productivity of Salvadoran firms."

  A reader could easily conclude from this statement that USAID/El Salvador is having a national level impact on the competitiveness and productivity of Salvadoran firms, and that competitiveness and productivity are increasing. In fact, USAID/El Salvador is working with a subset of Salvadoran firms – perhaps 15 percent or so, if firms with 10 employees or fewer are excluded from the denominator – and it is an open question whether the competitiveness and productivity of Salvadoran firms are increasing or not. The IMF, for example, takes the view that they are not, reporting that "a weakening of external competitiveness is likely to have contributed to low growth. Factors that have affected competitiveness include … high wage costs … problems related to lack of innovation … and … low quality of education, resulting in weak labor force skills."[14]

There were several reasons why needed contextual information was omitted from Mission reports. First, the Mission staff that prepared reports on the economic growth program were very familiar with the program and the environment that it is implemented in, and they may have assumed too much knowledge on the part of their readers. Second, some Mission staff wanted to leave a positive impression of their programs and this may have led them to emphasize positive developments. This is common practice in any type of persuasive writing, and we are not suggesting that Mission staff did anything underhanded or unethical. Rather, we are suggesting that a different strategy – taking pains to present a balanced picture of both successes and challenges, and pointing out unmet needs for assistance and constraints that are not being addressed due to insufficient resources or lack of political will on the part of the GOES – might produce better results. Finally, it should be noted that the Mission was following defined reporting formats with space limitations. In these circumstances, perfect clarity in reporting may be an unattainable goal.

As a result of reporting information that was not placed in context so it could be properly understood, USAID/El Salvador's reporting on the economic growth program could leave readers with an incorrect impression of the progress of the economic growth program or with unrealistic expectations of the contribution that USAID/El Salvador's program would

[13] Edwards, Sebastian, "The Slowdown of Economic Growth in El Salvador: An Exploratory Analysis," unpublished draft monograph, 2003, p. 38.
[14] International Monetary Fund, "El Salvador: Selected Issues – Background Notes" (IMF Country Report No. 05/270), August 2005, p. 4.

have on economic performance. This could lead decision makers to allocate resources based on decisions that are not based on an understanding of actual conditions in El Salvador, or could lead to disenchantment with the performance of USAID/El Salvador's economic growth program if better economic performance in El Salvador is not forthcoming.

Recommendation No. 7: We recommend that USAID/El Salvador require Aid to Artisans to periodically validate the formulas used to estimate the number of new jobs created or obtain information on the actual number of new jobs created directly from assisted firms.

Recommendation No. 8: We recommend that USAID/El Salvador implement a system to ensure that reports 1) clearly disclose the use of estimates or perhaps provide a range of values, when appropriate, rather than reporting estimates as precise figures, and 2) present sufficient contextual information to facilitate understanding of its reporting on the economic growth program.

Evaluation of Management Comments – In response to Recommendation No. 7 of our draft report, USAID/El Salvador stated that its partner for the artisan development activity will conduct a survey among a broad sample of firms assisted by the program to collect direct information of new jobs created by these firms. The results will then be compared to the formula estimates to verify deviations and make appropriate corrections. With regard to Recommendation No. 8, the Mission noted that the new global reporting template limits the ability of USAID missions to report on indicators and provide contextual information. The Mission also stated that it has disclosed the use of estimates, to the extent possible, and provided contextual information in reports for external use. The Mission requested closure on issuance of the final audit report.

Based on the information provided by USAID/El Salvador and our review of the FY 2007 Operational Plan, we consider that a management decision has been reached for Recommendation Nos. 7 and 8. We observed that the FY 2007 Operational Plan provided additional contextual information on reported results, although the Mission did not disclose that the reported numbers of jobs created under USAID-financed activities were estimates, did not disclose how the estimates were arrived at, and did not disclose that jobs created under the artisan development activity were part-time jobs. Determination of final action for these recommendations will be made by the Audit Performance and Compliance Division (M/CFO/APC).

Periodic Reviews of Reported Data Have Not Been Performed

Summary: USAID guidance suggests that periodic data quality reviews be completed to ensure completeness, accuracy, and consistency. Additionally, some Mission data quality assessment documentation stated that periodic spot checks of data would take place. However, economic growth responsible staff did not periodically verify the quality of their data as required. Instead, the staff relied on contractors to report and review data. As a result of not performing periodic quality reviews of the data collected for activity performance monitoring and, thus, over-relying on contractor reported figures, reported results may be inaccurate. Additionally, decision makers who rely on the performance data reported to them without verifying the quality of those data could make incorrect assessments as to how to utilize their limited resources most effectively.

USAID's Automated Directives System (ADS) 203.3.5.2 states that the Operating Unit and the Strategic Objective (SO) Team should be aware of the strengths and weaknesses of their data and to what extent the data can be trusted to influence management decisions. Additionally, USAID's *Performance Management Toolkit* supplementary guidance document states that the goal to assessing data from implementing partners and secondary sources is to be aware of the data strengths and weaknesses and the extent to which data can be trusted when making management decisions and reporting. It also states that a practical approach to planning data quality assessments includes an initial data quality assessment and periodic quality reviews for completeness, accuracy, and consistency.

Review of several of the Mission's data quality assessments indicates that the Mission would periodically validate the integrity of the data collected on job creation and increased sales through spot checks by the responsible CTOs. However, the CTOs did not conduct periodic testing and verification of the quality of the data they were being provided and, therefore, relied too heavily on the results reported by the implementing partners. For example, one CTO relied completely on a contractor to report the number of beneficiaries served by infrastructure activities and did not verify the amount of cost sharing claimed by communities. Another CTO relied on complicated estimates of new jobs that are provided by a contractor and did not check on the accuracy of these estimates. In general, Mission staff relied on contractors to report data and ensure data quality, and did not recognize the importance of independently verifying data quality.

Periodic verification of performance data provided by the partners could have allowed one CTO to recognize that the process used by one partner to record the increase in sales under the export development activity could be improved. We identified three errors with regard to reporting incremental sales. In one case, the error was the result of a data transcription error by USAID/El Salvador's contractor. In another case, the contractor misinterpreted the source data provided by the SME and recorded the wrong amount. Sales results for a third firm were incorrect because the spreadsheet contained an incorrect calculation formula. Another file showed that 45 firms had exported as of September 30, 2006 when the correct number was 48. In the cases mentioned above, none of the errors were significant; however, it is likely that there are similar types of errors throughout the spreadsheets, some of which may be significant.

Data quality assessments and periodic verification ensure consistent and reliable data is being collected for management decision making purposes as well as for reporting purposes. Without such assurances, decision makers may come to erroneous conclusions regarding the performance of their programs leading to imperfect management decisions, and the reporting of incorrect information to interested parties.

> *Recommendation No. 9: We recommend that USAID/El Salvador require Cognizant Technical Officers to periodically sample and review their implementing partners' data for completeness, accuracy, and consistency*.

Evaluation of Management Comments – In response to our draft report, USAID/El Salvador stated that it will issue a Mission Order to require CTOs to periodically select and review a sub-set of indicator data from implementing partners to review for completeness, accuracy, and consistency. A standard worksheet will be developed to record the results of this exercise.

Based on the information provided by USAID/El Salvador, we consider that a management decision has been reached for Recommendation No. 9. Determination of final action for this recommendation will be made by the Audit Performance and Compliance Division (M/CFO/APC).

Site Visits Are Not Documented

Summary: USAID's Automated Directives System (ADS) requires that CTOs write a brief report highlighting findings encountered during site visits to document the active management of awards. However, site visits were not formally documented because staff in the economic growth office did not think that it was a good use of their time to document them given their workload. Without properly documenting observations of the implementing partners' actual progress and compliance with the award requirements, Mission staff do not have a complete documented account of the progress of the project on which to base management decisions.

ADS 303.3.17 states that "site visits are an important part of effective award management, since they usually allow a more effective review of the project … When the Agreement Officer or CTO makes a site visit, the Agreement Officer or CTO must write a brief report highlighting findings, and put a copy in the official award file."

Additionally, USAID's *Guidebook for Managers and Cognizant Technical Officers on Acquisition and Assistance* states that the CTO should document all significant actions including any technical directions given to the contractor in the work file or a separate action file. The file must be maintained intact and updated by each successor CTO until the contract ends. Site visits are a key element in the CTO's ability to monitor the progress of contractors. Site visits allow the CTO to observe the contractor at work to determine if the performance is in compliance with the contract. These visits also allow the CTO to, among other things, check the actual contractor performance against the scheduled performance and verify reported performance progress.

Although some of the Mission's Economic Growth CTOs reported that they kept notes or reported on activities that were problem areas, most did not formally document and record their site visit findings in the award files as required. One CTO stated that he started documenting some site visits made during FY 2006. Another CTO explained that only problems that were encountered during site visits were documented and some CTOs did record notes during their visits, but did not regularly prepare formal site visit reports. According to staff, documenting each site visit became a low priority considering their workload.

In order to effectively manage a contract or cooperative agreement, the CTO must have a record of the progress of the implementing partner, whether positive or negative. The CTO's documentation of the partner's progress supports the Mission's actions with regard to addressing problems or taking advantage of positive momentum in the program or project. Without proper documentation of events and progress, there lies the possibility of inconsistent management of the program and, in the case of a new CTO being tasked with the program, incomplete information regarding the progress of the program that could result in erroneous decisions and inappropriate actions taken with regard to the program.

The Economic Growth Team Leader acknowledged this issue and explained that discussions are underway regarding the use of a standardized report for all CTO site visits.

Recommendation No. 10: We recommend that USAID/El Salvador require a written site visit report to document the purpose and the results of each visit.

Evaluation of Management Comments – In response to our draft report, USAID/El Salvador stated that it will issue a Mission Order to record site visits to projects documenting the purpose and results.

Based on the information provided by USAID/El Salvador, we consider that a management decision has been reached for Recommendation No. 10. Determination of final action for this recommendation will be made by the Audit Performance and Compliance Division (M/CFO/APC).

Other Matters

Two other matters came to our attention during the course of the audit that require corrective action by USAID/El Salvador. Specifically, obligations to the economic growth SOAG did not comply with forward funding requirements and the cost of equipment for the Superintendency of Competition was not justified.

Obligations to the Economic Growth SOAG Did Not Comply with Forward Funding Requirements

Summary: USAID policy states that, for new programs, missions should not initially forward fund obligations by more than 24 months, and subsequently should not forward fund obligations for more than 12 months beyond the end of the fiscal year in which the obligation takes place. However, the Mission exceeded these requirements for its economic growth SOAG in fiscal years 2004, 2005, and 2006 by a total of $27.4 million. Based on expected expenditures for 2007, the Mission currently has exceeded forward funding requirements by $11 million. This occurred because of (1) delays in program implementation, and (2) receiving funds on a straight-line basis, which does not take into account the expected expenditure levels for the program. As a result, excess funds of $11 million that could be used by USAID to fund activities during the current fiscal year remain idle.

ADS Section 602.3.3 states that for new programs, missions should not initially forward fund obligations by more than 24 months. Thereafter, as stated in ADS Section 602.3.2, program managers should not forward fund obligations for more than 12 months beyond the end of the fiscal year in which the obligation takes place.

However, USAID/El Salvador exceeded these requirements for its economic growth SOAG as follows:

Date of Obligation	Obligations	Unexpended Obligations as of 9/30/06	Excess Obligations
9/16/04	$15,459,000	$4,285,933	$4,285,933
6/15/05 and 9/27/05	$17,831,985	$12,129,497	$12,129,497
7/14/06 and 9/25/06	$16,187,527	$16,187,527	$11,002,957[15]
Total	*$49,478,512*	*$32,602,957*	*$27,418,387*

Based on the above, the Mission exceeded forward funding requirements by $4,285,933 for the FY 2004 obligations and by $12,129,497 for the FY2005 obligations. In addition, because the Mission had large outstanding obligations from prior years, the Mission should have only obligated about $5.2 million in September 2006 instead of $16.2 million. Therefore, the Mission exceeded forward funding requirements in fiscal years 2004, 2005, and 2006 by a total of $27.4 million.[16]

The large unexpended obligations balance was due to two reasons. First, the activities under the SOAG were slow to start due to various factors. A principal factor was the lengthy contracting process for several activities, including the lengthy negotiations of program proposals. Another factor was that the Mission's contracting office and economic growth office assumed regional responsibilities, which overburdened these offices and contributed to the delays. In addition, the watershed activity—funded by the SOAG—only began implementation in FY 2007. Second, the Mission received funds on a straight-line basis, which did not take into account the expected expenditure levels for the program. That is, the normal expenditures for a 5-year program are lower expenditures in years 1-2 due to start up, higher expenditures in years 3-4, and lower expenditures in year 5 as activities wind down. The Mission was hesitant to turn down and return the funds because there was no guarantee that it would receive the necessary funds in future years.

As a result, excess funds that could be used by USAID to fund activities during the current fiscal year remain idle. Because USAID/El Salvador was also concerned about the large pipeline,[17] the Mission performed a pipeline analysis of funding to the economic growth SOAG in November 2006. The analysis showed that based on the average quarterly expenditure rate in 2006, the current pipeline will be exhausted over the next 3 years. Furthermore, the analysis indicated that the Mission expects to expend the remaining total authorized program funding over the final three years of the program. The Mission projected expenditures for 2007 to be $21.6 million.[18]

[15] Amount obtained by taking the unexpended obligations of $32,602,957 as of September 30, 2006 less the projected expenditures for FY 2007 of $21.6 million.
[16] Amount obtained by adding the unexpended balances as of September 30, 2006 for FYs 2004 and 2005 and the expected unexpended balance at the end of FY 2007.
[17] Pipeline is synonymous with unexpended obligations.
[18] This assumes that the full amount authorized by the SOAG of approximately $68.8 million would be obligated and expended by the scheduled program end date of September 2009 and assumes a much higher expenditure rate for 2007, than in 2008 and 2009.

Even after assuming what appears to be an optimistic expenditure level in 2007 of $21.6 million, the Mission still has exceeded forward funding requirements by $11 million. The $11 million should be reprogrammed by USAID to fund other activities during the current fiscal year.

Recommendation 11: We recommend that USAID/El Salvador reprogram $11 million to program areas where the funds can be used within the current fiscal year.

Evaluation of Management Comments – In response to our draft report, USAID/El Salvador stated that it had already initiated actions to both accelerate expenditures and reallocate funding. Once it receives the final operating year budget for FY 2007, it will complete an analysis of the economic growth portfolio and make a management decision concerning reprogramming, invoking an exception to forward funding guidance, or implementing a combination of both options.

Based on the information provided by USAID/El Salvador, a management decision will be reached once the Mission decides on a firm plan of action with timeframes for implementing the recommendation.

Cost of Equipment for Superintendency of Competition Was Not Justified

Summary: USAID operating units are responsible for managing resources in a cost-effective manner. The scope of the proposed equipment procurement for the Superintendency of Competition was scaled back, so at least $119,355 of the $150,000 budget can be reprogrammed for other uses. Another $26,667 went to purchase video conferencing equipment that was not justified. This occurred because USAID/El Salvador and its contractor, in large part, deferred to the Superintendency in defining how the equipment budget would be used. As a result, a total of $146,022 can be reprogrammed for higher priority uses.

ADS Section 202.3.7 states that USAID operating units are responsible for managing the resources made available to them in a cost-effective manner.

USAID's contractor for the activity entitled "Customs and Business Environment that Promotes Trade and Investment" was assigned a budget of $150,000 on July 2006 to purchase supplies and equipment for the GOES Superintendency of Competition. According to the Task Order, the Superintendency should be equipped within the first six months of the activity. However, the scope of the proposed equipment procurement was scaled back drastically so that at least $119,355 of this amount can be reprogrammed for other uses. As of December 2006, there were no plans for using the $119,355. The remaining $30,645 was used to purchase the following software and equipment for the Superintendency of Competition:

Description	Amount
Video conferencing equipment (42" plasma monitor, high definition camera, and ancillary equipment and software)	$26,667

Forecasting and econometric analysis software	3,090
Website development software	888
Total	$30,645

According to USAID/El Salvador staff and USAID's contractor, the purpose of the video conferencing equipment was to enable the Superintendency of Competition to communicate with its counterpart offices in other countries in Central America and maintain contact with a consultant in Washington, DC. No estimate of how often video conferences would be held was available.

In our opinion, this rationale does not present a strong factual case for concluding that the cost of the video conferencing equipment is justified. Under certain conditions – i.e., where parties need to communicate intensively with one another, all have compatible equipment, and have the requisite support staff to resolve technical problems – specialized video conferencing equipment can provide a higher level of functionality than the less expensive alternatives. However, it is feasible to sustain rather intensive communications by telephone, e-mail, fax, and through free internet-based video messaging services. It is very likely that these less expensive means of communication can satisfy the Superintendency of Competition's needs, while conserving scarce resources for other needs.

The original $150,000 was budgeted for equipment for the Superintendency because USAID/El Salvador and its contractor were relying on preliminary estimates of needs. The video conferencing equipment was purchased (although not yet delivered to the Superintendency) because USAID/El Salvador staff and USAID/El Salvador's contractor in large part deferred to the Superintendency's judgment in deciding how the budget for equipment purchases should be used.

As a result, $146,022 can be reprogrammed for higher priority uses. (This amount may be reduced slightly when freight charges for returning the video conferencing equipment are taken into account.)

Recommendation No. 12: We recommend that USAID/El Salvador reprogram for higher priority uses the $119,355 budgeted for equipment for the Superintendency of Competition but not needed as well as the $26,667 that was spent for video conferencing equipment that is not justified.

Evaluation of Management Comments – In response to our draft report, USAID/El Salvador stated that the $26,667 in video conferencing equipment purchased by the contractor for the Superintendency of Competition has been returned. With regard to the $119,355, the Mission stated that no funds need to be reprogrammed because it suggested that the funds will likely be used for additional equipment needs in FY 2008 and FY 2009.

Based on the Mission's response and additional information provided by USAID/El Salvador, we consider that the Mission has agreed to reprogram $26,667 for higher priority uses since the video conferencing equipment will not be turned over to the Superintendency and the contractor has agreed not to bill USAID for the equipment. We consider that the Mission did not agree to reprogram the remaining $119,355 for higher priority uses since the funds will likely be used for the same purpose, only at a later date.[19] Accordingly, final action has been taken on this recommendation.

[19] The Mission believed that there was a misunderstanding regarding the $119,355. The Mission thought that these funds would be obligated in the future. We believe that the funds were already obligated since the scope of work indicated that all of the funds would be used within the first six months of the activity. However, because the task order is incrementally funded and there is no budget for the amounts obligated to date, this cannot be readily verified by reviewing the task order itself.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General/San Salvador conducted this audit in accordance with generally accepted government auditing standards. The purpose of the audit was to determine whether activities under USAID/El Salvador's economic growth activities achieved planned results and whether reporting provided stakeholders with complete and accurate information on the progress of the activities and the results achieved.

In planning and performing the audit, we assessed the Mission's controls related to its economic growth activities. The management controls identified included the Performance Monitoring Plan (PMP), the Mission's Annual Report, the Mission's data quality assessments, the Mission's annual self-assessment of management controls as required by the Federal Managers Financial Integrity Act, reports on the Cognizant Technical Officers' (CTO) field visits, program progress reports, and day-to-day interaction between Mission staff and program implementers.

With the exception of the watershed management activities, the audit covered all other activities under the Mission's second strategic objective, Economic Freedom: Open, Diversified Expanding Economies. The audit was conducted in El Salvador from October 4, 2006 to December 13, 2006. Our audit focused on the period from the start of the new economic growth strategy, July 1, 2005, through September 30, 2006. During that time, the Mission obligated $28.2 million and expended $15.6 million for the activities that were audited.

Methodology

To answer the audit objectives, we met with CTOs and implementing partners. We reviewed relevant documentation produced by USAID/El Salvador such as award documents including amendments, Mission correspondence, internally used worksheets for measuring results, the Mission Performance Plan, Annual Reports, and field visit reports. We reviewed contractor prepared documentation such as annual work plans and quarterly progress reports also.

In order to test whether targets were met, we reviewed all 19 activity-level indicators that were reported in the Mission's Performance Monitoring Plan as well as indicators reported in the Mission Performance Plan, the Congressional Budget Justification, and implementer awards and work plans.

In order to determine whether accurate information was reported, we compared results obtained from tests and interviews with the results presented in the Mission Performance Plan, the Congressional Budget Justification, and the Annual Report. We specifically verified reported accomplishments by doing the following:

- For the agricultural diversification, export promotion, and artisan development activities, we interviewed mission and/or implementing partner personnel and reviewed documentation to determine how results are collected for increased sales and new jobs. We then obtained information on actual and projected sales and compared the data to actual and expected program costs to obtain an idea of the effectiveness of the program. Limited testing to determine the accuracy of results reported consisted of the following:

- For the export promotion activity, we judgmentally selected 10 of 379 firms for review based on a variety of factors including the amount of assistance received, the amount of sales that was produced, and the type of business.

- For the agricultural diversification activity, we randomly selected 10 active program clients out of 507 total clients. We also traced the reported performance figures for increased sales and jobs created to the records kept by the USAID CTO and to the implementing partner's supporting records.

- For the artisan development activity, we traced the total sales reported for FY 2005 and FY 2006 to monthly sales reports. We then randomly chose reported sales for one month in FY 2006 to supporting documentation (i.e., invoices, artisan certifications). Finally, we recalculated jobs reported for FY 2005 and FY 2006 based on the formula provided by USAID's partner.

- For the financial services activity, we reviewed the process used by USAID in selecting the participating financial institutions. For each indicator, we then reviewed documentation provided from most of the participating financial institutions that support the consolidated results reported by the implementer. These indicators include the number of new small and medium borrowers, the new loans to small and medium enterprises, the total value of active new loans, and the number of people trained under the financial services program. We performed a walk-through of the consolidation process performed by the implementer to reach a conclusion on the accuracy of the reported data.

- For the small infrastructure activities, we analyzed the activity selection procedure and ensured that they were all properly authorized by USAID. We then reviewed the list of all the infrastructure activities, past and present, and judgmentally selected 3 of 10 projects to review. We visited a site where 500 meters of road was built and another site where 1,358 meters of an irrigation system was rehabilitated. We performed a desk review of documentation for a third infrastructure activity. We confirmed that each of the three activities were properly documented in the files and that the reported results matched actual results.

To determine the significance of our findings, we judged that the Mission met planned results if 80 percent of the performance targets were met. In judging the significance of variances found during the audit between reported accomplishments and supporting documentation, we considered variances of 5 percent or more to be significant and reportable.

MANAGEMENT COMMENTS

To: Regional Inspector General/San Salvador, Timothy E. Cox

From: USAID/El Salvador Director, Deborah Kennedy-Iraheta

Subject: Audit of USAID/El Salvador's Economic Growth Program (Report No. 1-519-07-00x-P)

Date: February 16, 2007

This memorandum responds to your subject draft report and transmits our comments on the thirteen recommendations contained therein. I appreciate the opportunity to comment on the recommendations. As requested, we have specified our agreement or disagreement with each recommendation as indicated below. In case of agreement, we have specified a target date for the identified actions.

Recommendation No. 1: "We recommend that USAID/El Salvador revise its performance targets for the economic growth program as required by ADS 203.3.4.5."

We concur with this recommendation. All performance targets stated in the Economic Growth Performance Management Plan (PMP) for fiscal years 2007, 2008 and 2009 will be revised as required by ADS 203.3.4.5 and adjusted if needed. Target date: Sept. 30, 2007.

Recommendation No. 2: "We recommend that USAID/El Salvador review its economic growth portfolio, using readily available information on economic costs and benefits, and take appropriate action to reduce costs or increase cost efficiency for those activities that it concludes are not cost effective."

We concur with this recommendation. For each activity, we plan to develop a matrix with calculations of expected, direct financial costs to be incurred by USAID and partners and contrast these costs to the expected, direct financial benefits during and after the activity period. We will not carry out an analysis using economic values such as those derived from opportunity cost, shadow price calculations, or other complex estimations of indirect costs and benefits. For those activities not deemed cost effective, this analysis will be used to take appropriate action by USAID managers. Target date: August 30, 2007.

Recommendation No. 3: "We recommend that USAID/El Salvador, working through its contractor, develop and make available to Government of El Salvador tax authorities information on tax incidence and compliance rates by taxpayer income level."

Recommendation No. 4: "We recommend that USAID/El Salvador obtain evidence that the Government of El Salvador has implemented a program to reduce tax evasion through transfer pricing schemes."

Recommendation No. 5: "We recommend that USAID/El Salvador build on its tax administration assistance by developing and implementing a plan to engage the

Government of El Salvador at the highest level in a dialogue on its tax structure, possibly including the need for a land or property tax, and drawing on the analytical capabilities of its current contractor or other sources of expertise as necessary."

As described in the audit report, USAID/El Salvador's assistance in tax policy and administration activity has achieved planned results, helping the Government to increase tax collections from 11 percent in 2001 to an estimated 13.6 percent in 2006 (including an increase of $344 million in CY 2006 alone). USAID/El Salvador is committed to ensuring our programs have maximum impact, and we therefore welcome the observations contained in the audit report as to opportunities to enhance the impact of the USAID activity. In this year's work plan for this activity, in addition to ongoing efforts to establish a computerized management information system that will improve tax compliance oversight and tax policy formulation, we will ensure our contractor includes the following specific actions:

1. Working with the GOES data base and Ministry of Finance personnel, carry out an analysis of tax incidence and compliance rates by income level; and

2. As part of the continued training and support for the Tax Investigation Unit (the key Salvadoran unit for fraud investigation), provide specialized training on transfer pricing and work with the unit to develop a set of written investigation guidelines for transfer pricing.

We have also instructed our contactor to initiate a comprehensive study of the El Salvador tax system, including opportunities for reform, and plan to share and discuss this report with high-level Government officials. These actions directly respond to concerns reflected in the audit report and are within USAID's manageable interest.

Since recommendations 3, 4, and 5 go beyond the scope of the audit report's objective (i.e., of determining whether activities have achieved planned results) and USAID's manageable interest, we recommend the suggestions on further improving activity impact be addressed to USAID/El Salvador through a Management Letter. As RIG staff can appreciate, the comprehensive study of El Salvador's tax system to be undertaken may well point to additional measures that USAID's tax policy and administration activity should address, including policy and legal reforms. The tenor and level of our tax policy dialogue with Salvadoran officials was heightened as a result of the October 2006 speech by the U.S. Ambassador calling for Salvadorans to pay their taxes; the urgency of executive branch action to increase revenues has only gotten more acute since then. We are confident that continued USAID technical support will lead to additional increases in revenues. Once the findings of the comprehensive tax study are available, USAID and the Government representatives will be able to agree upon an activity work plan and new targets which maximize impact while recognizing the difficult political environment and complex tax regime (including constitutional restrictions on double taxation) of El Salvador.

Recommendation No. 6: "We recommend that USAID/El Salvador obtain from the implementing partner of the export promotion activity an adequate operating manual for approval by the Contracting Office as soon as possible."

We concur with this recommendation. Indeed, USAID has made several requests to Nathan Associates regarding the submission of an operating manual that complies with

USAID rules and regulations. The latest version submitted by Nathan is being reviewed by the USAID Contracts Office. Target date: April 30, 2007.

Recommendation No. 7: "We recommend that USAID/El Salvador require Aid to Artisans to periodically validate the formulas used to estimate the number of new jobs created or obtain information on the actual number of new jobs created directly from assisted firms."

We concur with this recommendation. Aid to Artisans will conduct a survey among a broad sample of firms assisted by the program to collect direct information of new jobs created by these firms. The results will then be compared to the formula estimates to verify deviations and make appropriate corrections. Target date: June 30, 2007.

Recommendation No. 8: "We recommend that USAID/El Salvador 1) clearly disclose the use of estimates or perhaps provide a range of values, when appropriate, rather than reporting estimates as precise figures and 2) present sufficient contextual information to facilitate understanding of its reporting on the economic growth program."

We concur with this recommendation. However, it should be noted that new global reporting template of the USAID Operational Plan (OP) does limit the ability of USAID missions to report on indicators and denote estimates or use a range of values when reporting. Furthermore, the new reporting format of the OP places strict character limits on the text in the report. We have implemented this recommendation by disclosing the use of estimates and to the extent possible within reporting guidelines, we are providing contextual information in reports for external use. We request closure on issuance of the final audit report.

Recommendation No. 9: "We recommend that USAID/El Salvador require Cognizant Technical Officers to periodically sample and review their implementing partners' data for completeness, accuracy, and consistency."

We concur with this recommendation. We are drafting and will issue a Mission Order on site visits to require Cognizant Technical Officers to periodically select and review a sub-set of indicator data from implementing partners for completeness, accuracy and consistency. A standard worksheet will be developed for CTOs to record results of this exercise. Target date: June 30, 2007.

Recommendation No. 10: "We recommend that USAID/El Salvador require a written site visit report to document the purpose and the results of each visit."

We concur with this recommendation. We are drafting and will issue a Mission Order on site visits to require CTOs to record site visits to projects documenting the purpose and results. Target date: June 30, 2007.

Recommendation 11: "We recommend that USAID/El Salvador reprogram $11 million to program areas where the funds can be used within the current fiscal year."

The Mission concurs with the forward funding analysis and audit finding, and had prior to the audit already initiated actions to both accelerate expenditures and reallocate funding. However, in the case of several activities, U.S. foreign policy interests may best be served by exercising the authority granted to Mission Directors to approve an exception to the forward funding guidance, as permitted in ADS 602.3.5. Bilateral foreign assistance will decline precipitously in FYs 07 and 08, and the Mission will be focusing these resources on a reduced number of “program elements” identified in the new foreign assistance framework. As the Mission downsizes and refocuses our bilateral assistance program on fewer program elements, we want to ensure ongoing activities where future funding is not available can be brought to an adequate ending point that protects and maximizes the impact of past USG investments. Once we receive a final OYB for FY 07, the Mission will be able to complete our analysis of the Economic Growth portfolio and make management decisions concerning reprogramming, invoking an exception to forward funding guidance, or a combination of both in order to satisfy and close the recommendation. Target date: September 30, 2007.

Recommendation No. 12: “We recommend that USAID/El Salvador reprogram for higher priority uses the $119,355 budgeted for equipment for the Superintendency of Competition but not needed as well as the $26,667 that was spent for video conferencing equipment that is not justified.”

We partially concur with this recommendation. First, we concur with the recommendation to return the video conference equipment purchased by the contractor for the Superintendent of Competition. This equipment has already been returned by the contractor.

However, we believe that there is a misunderstanding regarding the remaining $119, 355. During this three year activity, $150,000 was originally programmed for equipment purchases for the Superintendency of Competition. With the return of the video conference equipment, no other equipment will be needed during FY 2007. That is, the recommendation asserts that the $119,355 is no longer needed, but rather it should say that these funds are not needed for equipment purchases this year. There will likely be additional equipment needs in FY 2008 and FY 2009, and FY 2007 and FY 2008 funds not yet received by the Mission would be used to meet these needs. Since no additional funds have been added into the agreement for equipment purchases, there are no funds to reprogram.

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Ave, NW
Washington, DC 20523
Tel: (202) 712-1150
Fax: (202) 216-3047
www.usaid.gov/oig