OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/GUATEMALA'S MANAGEMENT OF ITS P.L. 480 NON-EMERGENCY MONETIZATION PROGRAM

AUDIT REPORT NO.1-520-07-002-P
NOVEMBER 27, 2006

SAN SALVADOR, EL SALVADOR

Office of Inspector General

November 27, 2006

MEMORANDUM

TO: USAID/Guatemala Mission Director, Wayne Nilsestuen

FROM: RIG/San Salvador, Timothy E. Cox /s/

SUBJECT: Audit Report on USAID/Guatemala's Management of Its P.L. 480 Non-Emergency Monetization Program (Audit Report No. 1-520-07-002-P)

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

The report includes six recommendations intended to help improve program operations. Based on additional information that came to our attention after the draft report was submitted, we have revised some of the findings and recommendations and added a new recommendation. Also, based on your comments and documentation provided, we determined that a management decision has been reached for Recommendation No. 1. Determination of final action for Recommendation No. 1 will be made by the Audit Performance and Compliance Division (M/CFO/APC). Management decisions for Recommendation Nos. 2, 3, 4, 5 and 6 can be recorded when we have agreed with USAID/Guatemala on a firm plan of action, with target dates, for implementing the recommendations. In this regard, please advise us in writing, within 30 days, of the actions planned to implement these recommendations.

Again, I want to express my appreciation for 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

CONTENTS

SUMMARY OF RESULTS

The objective of the P.L. 480 Title II program is to provide food aid to vulnerable groups in emergency situations and to promote development programs critical to long-term food security. When authorized by USAID, cooperating sponsors who implement the program may either distribute the commodities directly to recipients or sell the commodities to generate foreign currency to support local development programs. The sale of U.S. agricultural commodities by cooperating sponsors (turning food assistance into program funds) is referred to as monetization. The monetization program in Guatemala is implemented by four cooperating sponsors. (See page 3.)

As part of a worldwide audit of P.L. 480 non-emergency monetization activities, RIG/San Salvador performed this audit to answer the following question:

- Are USAID/Guatemala's P.L. 480 monetization activities achieving selected planned outputs? (See page 4.)

We were not able to answer this question because in Guatemala no development programs were funded by commodity sales and hence no outputs were defined for USAID/Guatemala's monetization activities. Instead, monetization proceeds were used to defray expenses associated with distributing food assistance under the P.L. 480 food program and therefore contributed indirectly to achieving the outputs that were defined for the food distribution program. However, we found several opportunities to improve program operations. (See pages 5 to 13.)

The program relies on only one commodity (crude degummed soy oil), making the program vulnerable to supply and demand disruptions, and also leading the cooperating sponsors to rely on a single buyer. Relying on a single buyer puts the cooperating sponsors in a weak bargaining position and, as a result, the program incurred more than $250,000 in losses that were the responsibility of the buyer. Also, the cooperating sponsors paid the buyer $40,680 in damages when oil was delivered eight days late, but then failed to make a claim against the shipper that was responsible for the late delivery. Finally, in our opinion, it may be worthwhile for the cooperating sponsors to negotiate with the Government of Guatemala to see if the government is willing to contribute the revenue from taxes on soy oil imported under the program as suggested by USAID Regulation 11 and the 1998 P.L. 480 Monetization Manual. Since 2002, the government has collected an estimated $3.3 million in taxes on P.L. 480 soy oil. (See pages 5 through 13.)

This report recommends that USAID/Guatemala, working with the Office of Food for Peace as appropriate, (1) move to a market basket approach by selling additional commodities, hiring agents, or selling to third countries; (2) move toward an open and competitive approach to selling commodities rather than relying on a single buyer; (3) enforce the contract with the buyer which stipulates that the buyer accepts the survey report issued and transfer of title to the oil at the point of delivery, or change the contract so that title passes at some other point; (4) obtain evidence that the cooperating sponsors have reimbursed the program for $252,589 in losses that were the responsibility of the buyer; (5) ensure that the cooperating sponsors assert "Force Majuere" as a defense to the claim from the buyer, recover $40,680 from the buyer, and return the amounts recovered to the program; and (6) negotiate with the Government of

Guatemala to see if the government is willing to donate revenue from taxes on soy oil imported under the program to the program as a government contribution. (See pages 7 to 13.)

USAID/Guatemala agreed with the conclusions in our draft audit report for the most part, but believed that the report contained some recommendations that could not be implemented due to the market conditions in Guatemala. We agreed with the Mission on certain issues and revised the final report with careful consideration of the Mission's response to the draft report. However, there were certain issues where we disagreed with the Mission. In addition, based on additional information that came to our attention after we issued our draft report, we have revised one of the audit findings and added a new recommendation. Our evaluation of management comments is provided after each finding and recommendation in the report. USAID/Guatemala's comments in their entirety are included in Appendix II.

BACKGROUND

The Agricultural Trade Development and Assistance Act of 1954, also known as Public Law 480, is the principal mechanism through which the U.S. Government implements its international food assistance initiatives. The intent of this legislation, which has been modified many times, is to promote food security in the developing world through humanitarian and developmental uses of food aid. Food assistance provided under P.L. 480 is delivered to foreign countries under three separate programs - Title I, II and III - with the bulk of this food aid furnished under Title II, administered by USAID, to support targeted emergency relief operations and development projects. Title II projects are implemented through a variety of cooperating sponsors that include private voluntary organizations, non-governmental organizations, and international organizations.

The objective of the Title II program is two-fold: to provide food aid to vulnerable groups in emergency situations and to promote developmental programs critical to long-term food security. In other words, the Title II budget supports both emergency and non-emergency activities. In addition to funding the procurement of agricultural commodities, Title II funds are used to cover ocean freight, inland freight, and internal transport, storage, and handling costs. Other resources administered under Title II include cash grants awarded to cooperating sponsors to help pay administrative costs associated with food programs. [1]

USAID's Office of Food for Peace has primary responsibility for administering the Title II program. The Office of Food for Peace receives, reviews, and approves proposals from cooperating sponsors, awards the grants discussed above, and manages funds for non-commodity program costs, such as ocean freight.

With USAID's approval, cooperating sponsors may either distribute the commodities directly to recipients or sell the commodities to generate foreign currency to support local development programs. The sale of U.S. agricultural commodities by cooperating sponsors (turning food assistance into program funds) is referred to as monetization. Title II monetization began in 1986 in response to repeated requests by cooperating sponsors for additional funding to cover foreign currency costs associated with P.L. 480 food distribution programs. In recognition of these needs, Congress mandated that USAID permit cooperating sponsors to monetize annually at least 15 percent of the total value of Title II non-emergency commodities.

The P.L. 480 Title II monetization program in Guatemala is implemented by a consortium of four cooperating sponsors: Save the Children, SHARE, Catholic Relief Services (CRS) and CARE under an umbrella monetization agreement.[2] CRS is the leader for the consortium and receives 1 percent of food sales to cover the consortium's operating expenses.

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1 Section 202(e) of P.L. 480 authorizes the Office of Food for Peace to authorize additional funding to the cooperating sponsors to establish new programs under Title II or to support specific administrative costs for carrying out programs in foreign countries if the cooperating sponsors' Title II funding falls short. Because of the limited availability of 202(e) funds, the Office of Food for Peace restricts their use.

2 When two or more cooperating sponsors collaborate to monetize their donated commodities jointly, they are carrying out an umbrella monetization.

Each year, the cooperating sponsors prepare an analysis (called a Bellmon Analysis) for the P.L. 480 program to address the potential disincentive effects of U.S. food aid on agricultural production and marketing in recipient countries. The analysis focuses on 1) whether adequate storage facilities will be available in the recipient country at the time of the arrival of the commodity to prevent spoilage or waste of the commodity; and 2) whether the distribution of the commodity in the recipient country will result in a substantial disincentive to or interference with domestic production or marketing in that country.

Prior to fiscal year 2003, yellow corn and soy bean meal were monetized; since then only crude degummed soy oil has been monetized in Guatemala. Below is a table that describes the volume of monetized commodities from fiscal years 2002 through 2006:

Table 1: Volume and Sales Value of Monetized Commodities from FY 2002 through FY 2006

Volume (in Metric Tons) and Sales Value of Title II Commodities Monetized							
	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	MT Total	Total Value
Soy Bean Meal	17,570	-	-	-	-	17,570	$3,953,250
Yellow Corn	25,640	-	-	-	-	25,640	$2,692,200
Soy Oil	-	7,550	7,220	15,080	9,310	39,160	$27,875,780

This audit focused on monetization activities from fiscal years 2005 and 2006.

AUDIT OBJECTIVE

As part of a worldwide audit directed by the OIG's Performance Audits Division, the Regional Inspector General/San Salvador audited USAID/Guatemala's P.L. 480 non-emergency monetization activities to answer the following question:

- Are USAID/Guatemala's P.L. 480 monetization activities achieving selected planned outputs?

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

AUDIT FINDINGS

Are USAID/Guatemala's P.L. 480 monetization activities achieving selected planned outputs?

We were not able to answer this audit objective because in Guatemala no development programs were funded by commodity sales and hence no outputs were defined for USAID/Guatemala's monetization activities. Instead, monetization proceeds were used to defray expenses associated with distributing food assistance under the P.L. 480 Food Security Program and therefore contributed indirectly to achieving the outputs that were defined for the Food Security Program. The proceeds were primarily used to support administrative expenses such as internal transportation, handling, labor, storage, and warehousing associated directly with the distribution of commodities. The proceeds were also used to provide materials for agricultural and infrastructure projects.

The uses of monetization proceeds are verified through annual audits of the cooperating sponsors. In addition, during our audit, we scanned selected expenses incurred during fiscal years 2005 and 2006 for unusual activity and nothing came to our attention that would make us believe that the proceeds were not used as intended.

Although we could not answer the audit objective, we found several opportunities to improve program operations.

Reliance on One Commodity Increases Program Risks

Summary: The cooperating sponsors implementing the P.L. 480 program in Guatemala depend on monetization proceeds to financially support the administration of their food distribution program. Since fiscal year 2003, the P.L. 480 program has monetized only one commodity—crude degummed soy oil. Because of the risks associated with relying on a single commodity, and because the Guatemalan market for crude degummed soy oil is limited, both the 2005 Bellmon Analysis and a recent program evaluation in 2006 recommended that the program move to a market basket approach that monetizes more than one commodity. The program has explored monetizing other commodities, but finding other commodities that would meet all the necessary requirements under P.L. 480 has proven difficult. Reliance on one commodity entails a great deal of risk to the program because, if the commodity were to become unavailable or if the demand for it were to diminish, the program would suffer major consequences that would make it difficult or impossible to carry out developmental programs.

The cooperating sponsors implementing the P.L. 480 program in Guatemala depend on monetization proceeds to financially support the administration of their food distribution program. Since fiscal year 2003, the P.L. 480 program has monetized only one commodity—crude degummed soy oil. Crude degummed soy oil is primarily used for the production of refined oil, lard, and margarine for human consumption. The 2005 Bellmon Analysis cited several reasons why soy oil is a suitable commodity for monetization in Guatemala: demand for soy oil is expected to rise, importing soy oil does not create any disincentives for local production since soy oil is not produced in

Guatemala, and it has a relatively high per unit value.

However, depending on only one commodity entails a great deal of risk and, because the size of the Guatemalan market for soy oil is limited, both the independent consultants who conducted the 2005 Bellmon Analysis and the recent program evaluation in 2006 recommended that the program move to a market basket approach that monetizes more than one commodity. This move would also have the effect of reducing the risk inherent in selling only one product to one customer.

The program has explored the possibility of monetizing other commodities, but it has been difficult to find other commodities that have high demand, do not produce potential disincentives to local production, have relatively high value, and are produced for human consumption. Prior to fiscal year 2003, yellow corn and soy bean meal were monetized under the program, but these were used for animal feed and the Office of Food for Peace subsequently mandated that the commodities used under the monetization program had to be for human consumption. (The consortium argued, unsuccessfully, that although yellow corn and soybean meal were used to feed chickens, chickens and chicken eggs are vital sources of protein for Guatemalans.)

Relying on only one commodity places the program at greater risk because any disruption in the supply or demand of soy oil could drastically reduce the amount of local currency available to the program. The cooperating sponsors and the Mission have also expressed concern that monetization of soy oil alone will not satisfy the future local currency requirements of the P.L. 480 program in Guatemala. For example, on March 14, 2005 and January 24, 2006, CRS headquarters and the Mission Director, respectively, sent memos to the Office of Food for Peace requesting to resume monetization of soy bean meal and yellow corn along with soy oil to avoid shortfalls and other problems with the program.

There are several options for moving toward a market basket approach:

- The consortium should consider selling additional commodities. In the new multi-year assistance program proposal, which is the five-year plan for P.L 480 activities covering fiscal years 2007 through 2011, the consortium plans to add wheat to the monetization program. However, according to the 2005 Bellmon Analysis, in the past, monetizing wheat has been problematic and adding it as a commodity will be a considerable challenge. The challenges will be (1) to sell wheat that may not be of the same quality available from other suppliers in the country and (2) the buyers may not be able to arrange for letters of credit as required by USAID.

- Another possibility is to work with a major grain trader to monetize commodities, as recommended in the 2005 Bellmon Analysis. The advantage of this arrangement would be that the transaction between the trader and the buyer would have all the appearances of a regular commercial transaction, avoiding negative perceptions associated with donated food commodities.

- Another possibility is third country monetization (i.e., selling commodities in another country to fund developmental programs in Guatemala). Selling to a larger market would likely make it feasible to monetize additional commodities besides soy oil.

All three of these possibilities are options that should be explored by the Mission and the consortium to mitigate the program risk of relying on only one commodity.

Recommendation No. 1: We recommend that USAID/Guatemala seek approval from the Office of Food for Peace to move to a market basket approach by (a) selling additional commodities, (b) working with a major grain trader, and/or (c) selling to third countries.

Evaluation of Management Comments – In response to our draft report, USAID/Guatemala stated that the only feasible way to move towards a market basket approach is by selling additional commodities. Therefore, in the fiscal year 2007 Annual Estimate of Requirements, the monetization program will add wheat as a commodity for the monetization program.

Based on the information provided by USAID/Guatemala, 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).

The Monetization Program Should Move to an Open and Competitive Sales Approach

Summary: The 1998 Monetization Field Manual encourages open and competitive sales as opposed to non-competitive sales. However, the program has used a non-competitive sales approach, relying on only one large buyer, since fiscal year 2003. Other buyers were excluded from the program because of the requirement to arrange for a letter of credit and because they were only able to buy small quantities of oil. Relying on one buyer puts the consortium at a disadvantage in obtaining the highest price and also places the consortium at a higher risk of not being able to implement program activities if the buyer loses interest.

According to the Monetization Field Manual of 1998, "Where appropriate, USAID must support open and competitive sales as opposed to non-competitive sales." Competitive sales (auctions and tender) are preferred over negotiated sales because they offer a degree of transparency and potentially maximize sales proceeds. Specifically, the guidance states that open and competitive sales have several advantages over negotiated sales and administered prices:

- Auction/tender sales eliminate the inherent difficulties in determining a "market price" for monetized food aid.

- Auction/tender sales offer a degree of transparency that, except in the case of extremely immature markets, can facilitate access to food supplies by small-scale buyers.

- Auction/tender sales offer opportunities for realizing higher sales prices, thereby generating greater amounts of foreign currency proceeds for cooperating sponsor activities.

However, the program uses negotiated sales with only one buyer, who has been the sole buyer since fiscal year 2003. According to Catholic Relief Services, the leader of the consortium, there are three other potential buyers of soy oil in Guatemala. However, the consortium has only been able to sell the oil to one large buyer because the other potential buyers are relatively small and cannot provide letters of credit to satisfy the payment requirements imposed by USAID.

Relying on only one buyer is potentially detrimental to the program. If for any reason the buyer becomes uninterested or the relationship between the consortium and the buyer falters, the program will suffer. In addition, relying on one buyer limits the consortium's bargaining power. As described in the next section, the consortium has paid more than $250,000 in losses that were contractually the responsibility of the buyer; for fear that the buyer might withdraw from doing future business with consortium. The buyer knows that the consortium is eager to sell the commodities and therefore is able to arrange very attractive terms.

Relying on one buyer puts the consortium at a disadvantage in obtaining the most value for its commodities and also places the consortium at a higher risk of not being able to finance P.L. 480 program activities if the buyer chooses not to do business with the consortium.

Recommendation No. 2: We recommend that USAID/Guatemala seek approval from the Office of Food For Peace to move its monetization program to an open and competitive approach by relaxing the financial payment requirements so that other buyers can enter the market, replacing the existing commodity, adding other commodities or taking other measures to move in that direction.

Evaluation of Management Comments – In response to our draft report, USAID/Guatemala stated that the demand-market situation in Guatemala does not allow for the program to benefit from changes in payment requirements or moving from a negotiated sales process to one of competitive sales. The mission stated that although it would be ideal for a greater demand-driven market for the monetization commodities, the present country conditions have not reached the desired competitive levels to benefit from the open market sales. The mission also stated that the consortium has made significant efforts to find qualified buyers for the commodities but has not had any success. They stated that there are four potential buyers of crude degummed soy oil in the country. Of these four, only two were determined capable of effectively handling the receipt, storage and distribution of oil shipments, but only one showed interest in the program. Regarding wheat, the market is currently controlled by the millers association where only one buyer exists.

We considered the mission's view points on why the market conditions in Guatemala do not allow for competitive sales; however, we believe that moving towards a competitive sales approach will only benefit the program in the future. The intention behind the recommendation was to push the program towards an open and competitive approach, whether this means relaxing financial payment requirements so that other buyers can enter the market, replacing the existing commodity, adding other commodities or taking other measures to move in that direction. If relaxing payment requirements is not feasible, then the mission should look to other possibilities to move towards the competitive approach. Accordingly, we have slightly revised the recommendation to better state our intentions. Furthermore, although the mission stated in its response to the draft report that significant efforts were made to find qualified buyers for oil, we would like to see more evidence of the actions taken before agreeing to a management decision on this recommendation.

The Program Incurred Losses That Were the Responsibility of the Buyer

Summary: The contract with the buyer stipulates that an independent surveyor will establish the quantity of oil delivered based on a survey conducted on board the ship when it arrives in Guatemala. The contract further stipulates that title transfers to the buyer when the oil is offloaded from the ship. However, the consortium has not enforced the contract and has assumed responsibility for losses of approximately $250,000 that occurred after surveys were conducted and after the oil was offloaded. These losses were the buyer's responsibility. The consortium will need to enforce the contract with the buyer to prevent the program from incurring more losses in the future. Furthermore, the consortium will need to make a claim against the buyer to recover the losses incurred by the program or will be liable to USAID for those losses if a claim is not pursued.

According to the sales contract between the buyer and the consortium,

> CRS's responsibility[3] for the commodity ends at the time of discharge in Port Santo Tomas de Castilla, when the commodity passes beyond the vessel's permanent hose, which is the point of delivery to the buyer and where the responsibility of the latter begins, regardless of whether the buyer and his/her representative is present or not to receive the commodity.

Furthermore, the contract states that the buyer and the consortium will accept as definitive the tonnage discharged from the vessel according to the survey report performed at the point of delivery and issued by the hired independent surveyor. According to the contract, this survey report will be used as the basis on which final payment will be made.

However, since the beginning of the relationship between the buyer and the consortium, which began in fiscal year 2003 with the first oil sale, the consortium has accepted responsibility for the oil until the oil reached the buyer's permanent storage tanks through approximately two to three miles of pipe extending from the point of delivery at Port Santo Tomas de Castilla to the buyer's storage tanks.

[3] This responsibility is on behalf of the consortium made up of SHARE, CARE, Save the Children, and CRS.

Photo taken by buyer on August 18, 2006 of oil pipes extending from the port of delivery to the buyer's storage tanks. These pipes extend approximately two to three miles and the oil takes approximately 24 hours to transfer.

Photo taken by buyer on August 18, 2006 of storage tanks at the buyer's storage facilities.

When the oil is received at the port of delivery, an independent surveyor measures the quantity of the shipment. However, according to Catholic Relief Services, the buyer is not willing to accept that measurement as final because the measurements are sometimes inaccurate due to ship movements caused by waves at dockside. The buyer has requested that final measurements be made when the oil reaches his storage tanks, and the consortium has not enforced the contract terms for fear of losing the buyer's business. As a result, the consortium incurred substantial losses from fiscal years 2003 through 2005. The table below describes the losses:

Table 2: Losses Incurred from FY 2003 through FY 2005

Year	Losses Incurred
2003	$78,502
2004	$52,797
2005	$121,290
Total	*$252,589*

These losses were incurred because of problems with the pipes that transferred the oil from the vessel to the buyer's permanent tank, and, possibly, theft of the oil during transfer. The consortium took actions to control the losses such as repairing the pipes and even adding their own staff to monitor the transfer process, but the losses continued until the end of fiscal year 2005. In fiscal year 2006, after the buyer replaced some of his staff, the losses ended.

The losses incurred by the program were the responsibility of the buyer according to the contract. According to Regulation 11 of the Title 22 Foreign Relations, section 211.9, "if a cooperating sponsor acquires any right against a person or governmental or nongovernmental organization based on an event for which the person or organization is responsible that resulted in the damage, loss or misuse of any commodity, monetized proceeds or program income, the cooperating sponsor shall file a claim against the liable party or parties for the value of the commodities, monetized proceeds, or program income lost, damaged, or misused and shall make every reasonable effort to collect the claim." Furthermore, Regulation 11 states that, "cooperating sponsors who fail to file or pursue such claims shall be liable to USAID for the value of the commodities or monetized proceeds or program income lost, damaged, or misused." Therefore, because the cooperating sponsors did not make such claims against the buyer for the losses incurred, USAID should ensure that the cooperating sponsors reimburse the program for the losses that were the responsibility of the buyer.

Recommendation No. 3: We recommend that USAID/Guatemala and the cooperating sponsors enforce the contract which stipulates that the buyer accepts the survey report issued and transfer of title to the oil at the point of delivery, or change the contract so that title passes at some other point.

Recommendation No. 4: We recommend that USAID/Guatemala obtain evidence that the cooperating sponsors have reimbursed the program for $252,589 in losses that were the responsibility of the buyer.

Evaluation of Management Comments – In response to our draft report, USAID/Guatemala stated that the consortium has strengthened its procedures which included additional physical and program monitoring enhancements for the measurement and transfer of the oil. Some of these procedures included gaining complete access to the buyer's storage tanks upon arrival at port and transfer to the containers, using the independent surveyor's measurements, and timely identification of responsible party for any future losses. With these procedures in place, the mission does not see a need or benefit in modifying the terms and conditions of its present contract.

We disagree with the mission's response. The contract states that ownership of the oil transfers to the buyer when the oil passes beyond the vessel's permanent hose. Even though the consortium has implemented additional control procedures to prevent future losses, this is not the responsibility of the consortium. In fact, the consortium should not spend additional money to implement these procedures. The consortium should either enforce the contract terms which stipulates that the buyer accepts the transfer of title the oil at the point of delivery, or change the contract so that title passes at some other point. A management decision will be made for recommendation No. 3 when the mission develops a firm plan of action to enforce the contract with the buyer or to change the contract accordingly.

In addition, based on additional information (Section 211.9 of Regulation 11) that came to our attention after we issued our draft report, we have revised the audit finding and added a recommendation that the cooperating sponsors reimburse the program for losses that were the responsibility of the buyer. A management decision for Recommendation No. 4 can be recorded when we have agreed with USAID/Guatemala on a firm plan of action, with target dates, for implementing the recommendation.

Losses Were Not Claimed from the Shipping Company

In 2005, the buyer was supposed to receive a shipment of oil by January 15, but did not until January 23, eight days late. Due to the delay, the buyer had to buy a small amount of oil from other sources at premium prices to meet his business needs. The consortium paid the buyer $40,680 in damages caused by the late delivery of the oil, but then failed to claim this amount from the shipping company. According to CRS, although the shipper was responsible for this delay, the consortium did not make a claim against the shipper because it did not occur to them to do so. As a result, the P.L. 480 program lost $40,680 that could have been used to fund program expenses. Based on management comments received from USAID/Guatemala, we are making the following recommendation:

> *Recommendation No. 5: We recommend that USAID/Guatemala, ensure that the cooperating sponsors assert "Force Majuere" as a defense to the claim from the buyer, recover $40,680 from the buyer, and return the amounts recovered to the program.*

Evaluation of Management Comments – In response to our draft report, USAID/Guatemala stated that no legal recourse was available to the consortium to recover this amount since the owners of the ship declared "Force Majeure" (a French term that means "greater force" and is a common clause in contracts which essentially frees one or both parties from liability or obligation when an extraordinary event or circumstance beyond the control of the parties that prevents one or both parties from fulfilling their obligations under the contract) when the Coast Guard sent a letter to the owners of the ship indicating that the barge was not capable of carrying the oil. The charter was cancelled and a new one was issued at a later date resulting in the delay of the shipment.

In our opinion, when the ship owners declared "Force Majuere" as a defense to claims from the consortium, the consortium should have done the same and asserted "Force Majuere" as a defense to the claims from the buyer. Accordingly, we have revised Recommendation No. 5. A management decision for Recommendation No. 5 can be recorded when we have agreed with USAID/Guatemala on a firm plan of action, with target dates, for implementing the recommendation.

The Consortium May Negotiate to Retain Taxes as Host Country Contributions

According to 22 Code of Federal Regulations Part 211 and the Monetization Manual of 1998, cooperating sponsors are encouraged to negotiate with the host country to establish an agreement whereby taxes are charged, as in a commercial transaction, but the cooperating sponsors are allowed to retain the taxes as a host country contribution to the program. However, the cooperating sponsors have not negotiated with the Government of Guatemala to allow for the retention of taxes (currently paid by the buyer) as a host country contribution to the program. The cooperating sponsors have not done this because they were not aware of the possibility of negotiating such an agreement. If the cooperating sponsors negotiate such an agreement, this could result in millions of dollars of additional funding for the program. Below is a table summarizing the estimated taxes paid from FY 2002 through 2006:

Table 3: Estimated Taxes Paid from FY 2002 through FY 2006

Year	Sales Value	Taxes
FY 2002	$6,645,450	$797,454
FY 2003	$3,705,110	$444,613
FY 2004	$4,852,690	$582,322
FY 2005	$8,063,020	$967,562
FY 2006	$4,609,510	$553,141
Totals	*$27,875,780*	*$3,345,092*

Recommendation No. 6: We recommend that USAID/Guatemala work with the cooperating sponsors to negotiate with the Government of Guatemala to permit the cooperating sponsors to retain the taxes paid by the buyer as host country contributions to the program or negotiate further increases in the Government of Guatemala cash contributions in future monetization agreements.

Evaluation of Management Comments – In response to our draft report, USAID/Guatemala stated that previous informal discussions with the Government of Guatemala (GOG) indicated that renegotiating for additional contributions would put the consortium at risk with the amount of contributions already agreed to. Therefore, the Mission does not feel the need to negotiate these contributions with the GOG. However, the Mission stated that they are committed to continue using their best efforts to negotiate further increases in cash contributions from the GOG in future monetization agreements.

We have carefully considered the Mission's comments, but we still believe that it would be worthwhile for the mission to negotiate additional cash contributions for the program. We have revised the recommendation to include negotiating cash contributions in future monetization agreements. A management decision for Recommendation No. 6 can be recorded when we have agreed with USAID/Guatemala on a firm plan of action, with target dates, for implementing the recommendation.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General/San Salvador conducted this audit in accordance with generally accepted government auditing standards. This audit is part of a worldwide audit of P.L. 480 non-emergency monetization activities. The audit was designed to determine if USAID/Guatemala's P.L. 480 non-emergency monetization activities achieved selected planned outputs for development programs funded by commodity sales.

In planning and performing the audit, we reviewed and assessed the effectiveness of USAID/Guatemala's management controls related to monetization activities. The management controls assessed included the Mission's 2006 operational plan, development activity proposals, annual results reports from cooperating sponsors, and annual reports on commodity requirements from the cooperating sponsors. We also reviewed the Mission's management assessment report and the Mission's internal control self assessment pursuant to the Federal Manager's Financial Integrity Act for fiscal year 2005 to determine whether the Mission had taken corrective actions for identified weaknesses.

During the audit, we interviewed USAID/Guatemala officials, cooperating sponsor officials, the buyer of the monetized commodity, and the regional food security advisor. Of the four cooperating sponsors for the monetization program, we visited the office of one cooperating sponsor, Catholic Relief Services, which was the leader of the cooperating sponsors' consortium. We also visited the buyer's office in Guatemala.

The five-year program, which began in fiscal year 2002, is expected to end in fiscal year 2006. Our audit focused on activities that took place during fiscal years 2005 through 2006 (as of the first day of fieldwork – August 8, 2006). During that time, 24,390 metric tons of crude degummed soy oil was monetized with proceeds of $12,672,530. Monetization proceeds of approximately $893,000 were used to purchase materials and supplies for agricultural and infrastructure development projects in fiscal year 2005.

The audit fieldwork was performed in Guatemala from August 8, 2006 through August 23, 2006.

Methodology

We were not able to answer the audit objective because in Guatemala no development programs were funded by commodity sales and hence no outputs were defined for USAID/Guatemala's monetization activities. Instead, monetization proceeds were used to defray expenses associated with distributing food assistance under the P.L. 480 food program and contributed indirectly to achieving the outputs that were defined for the food program.

We conducted interviews with USAID/Guatemala officials, the buyer, and cooperating sponsor representatives from Catholic Relief Services, Save the Children, SHARE, and CARE to determine the roles and responsibilities for managing various aspects of the monetization process in Guatemala. We also reviewed the relevant U.S. laws governing the P.L. 480 Title II Program including 22 Code of Federal Regulations Part 211 as well as applicable USAID policies and procedures such as the Monetization Field Manual from 1998. Additionally, we reviewed USAID/Guatemala and cooperating sponsors' documentation such as the development activity program documents, cooperating sponsors' annual estimated requirements, cooperating sponsors' annual results report, the 2005 Bellmon Analysis for Guatemala, the contract agreements with the buyer, and host country agreement with the Government of Guatemala, and the 2006 program evaluation report.

MANAGEMENT COMMENTS

Date: October 27, 2006

To: Tim Cox
RIG/A/San Salvador

From: Wayne Nilsestuen,
USAID/Guatemala Director

Subject: Mission response to Draft Audit Report on USAID/Guatemala Management of P.L.480 Title II Non-Emergency Monetization Program.

I. Background

Subject draft audit report dated September 19, 2006 includes five recommendations for action by the Mission.

This memorandum addresses the Mission's position on each of the draft audit recommendations and requests closure of recommendations 1, 2, 3, and 5 upon issuance of the final report. Based on the comments and evidence provided in this memorandum, we also request RIG consideration of excluding finding and recommendation No. 4 in its final audit report.

II. Listing of draft audit recommendations and USAID/Guatemala request for closure/exclusion upon issuance of final audit report

A. Recommendation No. 1: We recommend that USAID/Guatemala seek approval from the Office of Food for Peace to move to a market basket approach by (a) selling additional commodities, (b) working with major grain trader, and/or (c) selling to third countries.

Discussion/Conclusions: Working closely with our Office of Food for Peace in Washington and the Consortium in Guatemala, we have concluded that the one and only economically feasible alternative for moving our PL-480 Title II Monetization Program towards a market basket approach is by selling additional commodities. Based on this and as reflected in Attachment I of this memorandum, the Title II implementers' Annual Estimate of Requirements (AER) for FY-07 now include both CDSO and wheat for the program. According to market size and Cooperating Sponsor (CS) funding needs, 75% of proceeds will be generated from the monetization of CDSO and the remaining 25% will come from wheat.

Option "b" which suggests working with major grain traders was discussed and determined not feasible due to the increased costs (fees for sale) it would cause to the program.

Option "c", which suggests selling to third countries, has also been assessed by the consortium and considered not viable on economic grounds because of the complexities in establishing it for a relatively small program with only two commodities and the extensive time and effort necessary for coordinating, managing and monitoring its implementation.

B. <u>Recommendation No. 2</u>: We recommend that USAID/Guatemala seek approval from the Office of Food for Peace to move its monetization program to an open and competitive approach by relaxing the financial payment requirements imposed on buyers and holding auctions or tender sales.

Discussion/Conclusions: Food for Peace, the Mission and the Consortium have discussed, with no real positive results, the possibility and benefits of relaxing the financial payment requirements imposed on buyers and of holding auctions or tender sales under present Guatemala market conditions. As explained below, present demand-market situation in Guatemala does not allow for the program to benefit from changes in payment terms or moving from a negotiated sales process to one of competitive sales. Although we would wish for a greater demand-driven market for our Title II commodities, present country conditions have not reached the desired competitive levels to benefit from open market sales.

The Consortium has made significant efforts to find qualified buyers for the two commodities (CDSO and wheat) under our PL-480 Title II Monetization program in Guatemala with the following results.

1. <u>Crude Degummed Soybean Oil (CDSO</u>)

The consortiums assessment of the CDSO demand-market in Guatemala concluded that:

a. Only four potential buyers exist within the country;
b. Of the four potential buyers, only two were determined capable of effectively handling the receipt, storage and distribution of oil shipments, and that of these two potential buyers, only one showed interest in the program.
c. The remaining two buyers were declared by the consortium as too small to handle a 2000 metric ton shipment of oil (minimum amount allowed by Washington for shipment under a Title II monetization program) or were determined of high risk for participation in the program.
d. Based on "a" through "c" results, the consortium did the only possible thing, negotiate the best price and conditions with the sole remaining potential buyer of CDSO in country.

2. <u>Wheat</u>

The wheat market in Guatemala is currently controlled by the Guatemalan Millers Association where all large, medium and small millers are integrated as one unit. Therefore, only one buyer exists and there is no competition. This Association requires that we monetize through them in order to reach small mills that otherwise would have no access to the PL-480 Title II wheat.

Considering the results of our consultations with the Office of Food for Peace in Washington and of their agreement to the above conclusions, we request Recommendations No. 1 and No. 2 be closed upon issuance of the final report.

C. <u>Recommendation No. 3</u>: We recommend that USAID/Guatemala ensure that cooperating sponsors enforce the contract which stipulates that the buyer accepts the survey report issued and transfer of title to the oil at the point of delivery, or change the contract accordingly.

Discussion/Conclusion: In order to further improve the accuracy of the final surveyors report and avoid possible future discrepancies/disagreements between the consortium and the buyers' measurements of CDSO - upon arrival at port and transfer to the containers, the buyer gave the consortium complete access to his storage tanks which were re-calibrated by an independent surveyor contracted by the Consortium. In addition, the Consortium has strengthened its procedures for ensuring the accuracy of all measurements (product shipped-based on shipping documents; and product received at port and transferred to buyer's containers based on independent surveyor's measurements along ship side and at storage tanks) and for timely identification of the party (shipper or buyer) responsible for any possible future losses of PL-480 Title II products. Since we feel that with these additional physical and program management/monitoring enhancement the Consortium will be able to maintain its fiscal year 2006 "cero losses" rating, we see no need or benefit in the Consortium modifying the terms and conditions of its present contracts.

Based on the above program oversight and operations improvements, the results of such enhancements in fiscal year 2006 and projected into the future, and of the Consortiums clear understanding of its responsibility to enforce present contract terms and conditions we request Recommendation No. 3 be closed upon issuance of the final audit report.

D. <u>Recommendation No. 4</u>: We recommend that USAID/Guatemala, in coordination with the cooperating sponsors, work towards recovering $40,680 from the shipping company and returning the amounts recovered to the program.

Discussion/Conclusion: As reflected in Attachment II to this Memorandum and in the following list of events, the "voyage – Sea Crest" triggering the condition leading to the draft audit report finding was declared "Force Majeure" by "Owners". Therefore no legal recourse is available to implement Recommendation No. 4. by the Consortium or USAID/Guatemala to recover the $40,680 mentioned in the report.

List of events leading to the audit report finding and recommendation follow:

1. The CDSO Barge "Sea Crest" was designed and built to carry caustic soda. However, new owners received permission in July 2004 from the US Coast Guard to carry vegetable oil. Since this approval, the Sea Crest has carried two cargoes of Vegoil.

2. The barge was fixed on November 2004 to lift a cargo of VegOil. After fixing the cargo, the barge underwent its annual Coast Guard Inspection (COI) and the coast Guard issued a new COI without VegOil listed as an acceptable cargo.

3. The Coast Guard sent a letter to owners indicating that the barge was not capable of carrying Vegoil. The charter was cancelled and a new freight re-tender issued.

4. The owners of the Sea Crest underwent discussions with the Coast Guard and their naval architect to find a solution. However, the Coast Guard did not yield on their position and as a consequence, the owners declared Force Majeure for the Sea Crest voyage. A claim can not be processed once Force Majeure is declared. Therefore, CRS as the lead agency of the consortium has no legal recourse to pursue the recovery of the $40,680.

Based on the above occurrences and "Force Majeure" declaration, we request RIG/SS consideration of deleting finding and recommendation No. 4 from the final audit report.

E. Recommendation No. 5: We recommend that USAID/Guatemala work with the Cooperating Sponsors to negotiate with the Government of Guatemala to permit the cooperating sponsors to retain the taxes paid by the buyer as host country contributions to the program.

Discussion/Conclusion: USAID/Guatemala and Cooperating Sponsor members of the Consortium, feel that they have been extremely successful in their difficult negotiations for acceptable counterpart contributions from the Government of Guatemala (GOG) in support of the program. Currently the GOG has agreed to contribute US$4,605,262 on an annual basis to our PL-480 Title II monetization activities. Said amount is far beyond the amount that could be recovered from the value added tax (VAT) amount levied on Title II commodity sales. Although, we (the Mission and the Consortium) find value in the auditors suggestion of negotiating further increases to the GOG's agreed upon counterpart contributions. However, our previous informal discussions with the GOG indicate that reopening negotiation NOW for an additional contribution equal to the amount of VAT collections (VAT is equal to 12% of sales) could not only be extremely complex, but also put at risk present agreed upon cash contribution levels of over 80% of yearly program sales. Based on the expressed concerns and of our commitment to continue using our best efforts to negotiate further increases in GOG cash contributions in future monetization agreements we request this recommendation also be closed upon issuance of the final audit report.

III. Summary of requested actions

Based on the above, USAID/Guatemala requests RIG/SS agreement to close draft audit recommendation numbers 1, 2, 3, and 5 and exclusion of draft audit finding and recommendation No. 4 upon issuance of the final audit report.

We would also like to take this opportunity to thank RIG/SS auditors for their professionalism in the performance of subject audit.

Early concurrence with the Mission's requested actions is appreciated.

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