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REPORT TO

THE CONGRESS OF THE UNITED STATES

AUDIT OF LOAN PROGRAM FINANCIAL STATEMENTS FOR FISCAL YEARS 1962, 1963, AND 1964

AGENCY FOR INTERNATIONAL DEVELOPMENT

UNITED STATES GENERAL ACCOUNTING OFFICE

BY

THE COMPTROLLER GENERAL

OF THE UNITED STATES

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COMPTROLLER GENERAL OF THE UNITED STATES
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To the President of the Senate and the
Speaker of the House of Representatives

Herewith is our report on the audit of the Agency for International Development Loan Program financial statements for fiscal years 1962, 1963, and 1964. As shown in the report, this program encompasses over one thousand signed loan agreements totaling about $12 billion and having outstanding balances on June 30, 1964, of $7.4 billion excluding interest. Many of the loans are repayable over a 40-year period.

The financial statements accompanying our report, in our opinion, do not present fairly the financial condition of the Loan Program at June 30, 1964, or the results of operations of the program for the fiscal years 1962, 1963, and 1964. Certain financial statement balances have been materially overstated and others understated because of accounting practices that we believe are not sound. Net income for each of the 3 fiscal years and the accumulated net income shown in the June 30, 1964, Statement of Financial Condition are materially overstated because of exclusion of administrative expenses. Although fiscal year 1964 is the latest period covered by the statements presented in our report, the basic deficiencies and underlying causes to which we direct our recommendations continue into the current fiscal year.

It is to be recognized, however, that the Loan Program has unique aspects which do not lend themselves to conventional evaluation processes and which significantly affect the financial position of the program. The program assets are shown in the June 30, 1964, Statement of Financial Condition at their full face value at that date. No allowance has been made for future losses which may be sustained on loans and interest receivable, although a substantial part of the assets consists of foreign currency cash balances and loans and interest receivable which are repayable in foreign currency without maintenance-of-value provisions and which are not freely convertible to United States dollars. Because of the many indeterminable factors which may affect these loans and the related interest receivable, we do not believe that future losses can be estimated with the degree of reliability necessary to arrive at a meaningful allowance for such losses. (See pp. 9 through 15.

The Agency's accounting and financial management system has a number of significant weaknesses and does not fully comply with the accounting principles and standards prescribed by the Comptroller General. The system does not, in our opinion, provide an adequate foundation for the Agency's current and prospective financial management needs for planning, programming, budgeting, accounting, and reporting in respect to both the Agency's internal management responsibilities and its responsibilities to the Congress.

The need for a substantially improved financial management system is emphasized by the multibillion dollar size and diversity of the Loan Program, by the longevity of the operation, and by the President's recent directive requiring agencies to establish integrated planning, programming, and budgeting systems.

AID recently has prepared a statement of basic accounting policy which is intended to provide a sound foundation for a revision of its overall accounting manual. Further, the Agency has initiated plans for review and revision of its Loan Program accounting system and has agreed to our proposal that internal audits be instituted. We plan to continue to work with the Agency in these developments. We are recommending that the Agency's system of accounts and reports provide for the allocation of applicable administrative expenses to the Loan Program in order to provide more meaningful information on the overall costs and results of Loan Program operations; to this the Agency has not agreed.

The Agency's recent actions are encouraging to the extent that they disclose an awareness of its financial management needs and the initiation of a plan of action. However, we do not believe that the Agency will be able to fully discharge its responsibility for accounting and reporting under the law (Foreign Assistance Act of 1961 and the Budget and Accounting Procedures Act of 1950) unless it makes the kind of improvements in its accounting, internal controls, and reporting which we have recommended. While we believe that the circumstances described above will preclude an unqualified opinion on the financial statements, we believe also that, when such improvements have been accomplished, we will be able to render an opinion properly qualified to reflect unique aspects of the program.

Copies of this report are being sent to the President of the United States; the Director, Bureau of the Budget; the Secretary of State; and the Administrator, Agency for International Development.

Frank H. Weitzel

Acting Comptroller General
of the United States

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REPORT ON

AUDIT OF

LOAN PROGRAM FINANCIAL STATEMENTS

FOR

FISCAL YEARS 1962, 1963, AND 1964

AGENCY FOR INTERNATIONAL DEVELOPMENT

INTRODUCTION

The General Accounting Office has made an audit of the Agency for International Development (AID) Loan Program financial statements for the fiscal years ended June 30, 1962, 1963, and 1964, pursuant to section 635(g)(5) of the Foreign Assistance Act of 1961 (22 U.S.C. 2395). This section of the act provides that the President shall cause to be maintained an integral set of accounts for loans made under the act which shall be audited by the General Accounting Office in accordance with principles and procedures applicable to commercial corporate transactions as provided by the Government Corporation Control Act, as amended (31 U.S.C. 841 et seq.). The scope of our audit, which was conducted at the AID headquarters office in Washington, D.C., is set forth on page 51 of this report. Recent General Accounting Office reports to the Congress on financial aspects of the AID Loan Program are shown in appendix I.

The Foreign Assistance Act of 1961 is the organic legislation for the current foreign assistance program. Section 621 authorized the President to exercise his functions under this act through such agency as he may direct. Pursuant to Executive Order 10973 of November 3, 1961, AID was established as an agency within the Department of State having the responsibility of carrying out the economic foreign assistance program of the United States and of coordinating the military and economic assistance programs.

The economic assistance program is designed to promote economic and social development in less developed areas of the world and to help maintain economic and political stability. Assistance is extended through grants of funds and by loans. Section 635(a) of the Foreign Assistance Act of 1961 requires that assistance in the form of loans be emphasized wherever possible, and, in accordance with this policy, loans have replaced grants as the principal means of extending economic assistance in recent years. At June 30, 1964, loans receivable administered by AID amounted to $7,415,800,000.

ORGANIZATION AND MANAGEMENT

The functions of AID are directed by an Administrator who is appointed by the President, by and with the advice and consent of the Senate, and reports directly to the Secretary of State and the President. He is charged with the central direction and responsibility for the economic assistance program and coordination of the military and economic assistance programs. The organizational structure of the Agency consists of the Office of the Administrator, management offices and various staffs to assist the Administrator in managing the affairs of the Agency, four regional bureaus--Latin America, Africa, the Near East and South Asia, and the Far East--to oversee the development and carrying out of the programs, and United States AID missions in recipient countries which have field responsibility for the programs.

Overall responsibility for the accounting, auditing, and budgeting activities of AID is vested in the Office of the Controller. The Accounting Division is responsible for the accounting and financial reporting of all AID programs, and the International Loan Branch is the specific organizational unit responsible for the accounting for the Loan Program. The principal AID officials responsible for the administration and accounting for the Loan Program during the period covered by our audit are listed in appendix II.

DEVELOPMENT LOAN COMMITTEE

Section 204 of the Foreign Assistance Act of 1961 provided for the establishment of an interagency Development Loan Committee, consisting of officers from such agencies of the United States Government as the President may determine, which shall, under the direction of the President, establish standards and criteria for development lending operations in accordance with the foreign and financial policies of the United States. By Executive Order 10973, November 3, 1961, the President established a committee consisting of representatives of AID, the Department of State, the Department of the Treasury, and the Export-Import Bank of Washington. The representatives of this committee during the period covered by our audit are listed in appendix III.

LOAN OPERATIONS

The two principal legislative authorities under which AID may currently make loans are the Foreign Assistance Act of 1961 and the Agricultural Trade Development and Assistance Act of 1954, commonly known as Public Law 480. Loans made under the Foreign Assistance Act of 1961 are funded from annual dollar appropriations; loans made pursuant to Public Law 480 are funded from the foreign currency proceeds accruing to the United States from the sale of surplus agricultural commodities.

In addition to the responsibility for administering loans made by AID since the Agency was established in November 1961, AID is responsible for administering loans made pursuant to several legislative authorities in existence at various times since the foreign assistance program was initiated following World War II. These loans were previously administered by predecessor agencies to AID and, for certain Public Law 480 loans, by the Export-Import Bank of Washington.

Loans administered by AID have been made directly to governments of foreign countries, to autonomous government agencies, and to private enterprises in foreign countries and vary widely as to purpose, repayment period, form of repayment, and interest rate. In this report we have categorized the loans by the legislative authority under which the agreements were originally made. A schedule showing the status of loan agreements under each of these legislative authorities is presented as appendix IV. A description of the various legislative authorities is presented as appendix V. A brief summary of the outstanding loans being administered by AID at June 30, 1964, follows:

Legislative authority	Outstanding balance (millions)
Foreign Assistance Act of 1961:	
Section 201	$ 983
Section 251	301
Section 401	183
Agricultural Trade Development and Assistance Act of 1954:	
Section 104(d)	7
Section 104(e)	104
Section 104(g)	2,294
Latin American Development Act	91
Corporate Development Loan Fund	1,330
Mutual Security Act of 1954	1,007
Legislative authorities prior to Mutual Security Act of 1954	1,115
Total	$7,415

As a preface to our comments on the Loan Program financial statements, we believe that recognition should be given to the difficulties under which the Agency began its combined lending functions when it was established in November 1961. In addition to administering and accounting for new loans authorized by the Foreign Assistance Act of 1961, the newly created Agency was faced with unusual problems in consolidating the administration and accounting for several large and varied Loan Programs formerly carried on by other agencies.

After the accomplishment of these consolidations, AID recently has prepared a statement of basic accounting policy which is intended to provide a sound foundation for further systems developments. That statement was transmitted by AID to the General Accounting Office December 20, 1965, and is now being reviewed.

Certain general information pertaining to the Loan Program and definitions of some of the terms used throughout this report are presented below.

MAINTENANCE-OF-VALUE

Many of the loans administered by AID are repayable in the local currency of the borrower. As a protection against fluctuations in the value of foreign currency units in relation to the dollar over the life of such loans, some of these loan agreements include maintenance-of-value provisions. In general terms, "maintenance-of-value" means that the dollar value of the foreign currency repaid by the borrower must equal the dollar value of the loan disbursements when the funds were disbursed to the borrower. The number of foreign currency units necessary to liquidate principal and interest installments due is governed by the going exchange rate at the time the payment is made. Small exchange rate gains and losses have been recognized by AID on loans with maintenance-of-value provisions because of slight differences in the rates of exchange used by the borrowers to make payments and the rates of exchange used by AID to record the transactions in accordance with rates prescribed by the Treasury Department. For loans repayable in foreign currency without maintenance-of-value provisions, the exact number of foreign currency units to be repaid is specified in the loan agreement or is in some other manner permanently fixed. The value of the units repaid is not a consideration in loans of this type, and substantial exchange rate losses have been incurred.

VALUATION OF FOREIGN CURRENCY BALANCES AND TRANSACTIONS

Since January 1, 1962, AID has valued foreign currency accounts and transactions at rates of exchange prescribed by the Treasury Department. Rates of exchange applicable to the currency units of each foreign country are prescribed quarterly and generally are based on the latest available Treasury Department selling rate in each country. Unless otherwise denoted, all amounts used in this report are stated in terms of dollars. These amounts, however, may consist entirely of dollars, the dollar equivalent of a number of foreign currency units, or a combination of both.

UTILIZATION OF FOREIGN CURRENCY BY AID LOAN PROGRAM

Foreign currencies generated by the sale of surplus agricultural commodities generally are not freely convertible to other currencies. For the most part these currencies are expended by the United States in the originating country in accordance with restrictions imposed in the sales agreements and with applicable legislation governing the disposal of such currencies. One of the principal uses of these foreign currencies is to fund loans to the countries purchasing the agricultural commodities. Repayments of these loans and payments of interest to the United States are also generally restricted as to their use.

UTILIZATION OF DOLLARS BY AID LOAN PROGRAM

The dollars used by AID to currently fund dollar loans are appropriated annually by the Congress. In recent years, the growing concern over the net dollar outflow from this country has led to increasing emphasis by AID in ensuring that economic foreign assistance dollar expenditures, including dollars disbursed as loans, are used to the maximum possible extent to procure United States goods and services. According to AID, more than 80 percent of the funds appropriated to AID in fiscal year 1964 were committed for the purchase of United States goods and services.

COMMENTS ON FINANCIAL STATEMENTS

The financial statements included in this report as schedules 1 through 4 are the same as those prepared by AID and submitted to us. Certain suggestions made by us on statement format were accepted by AID and incorporated in the final statements transmitted to us. Particularly noteworthy in this respect was the agreement by AID to show the substantial exchange rate loss, incurred when six loan agreements were amended to delete the maintenance-of-value provisions, as extraordinary losses in the Statements of Income and Expense. Also at our suggestion, prior-year adjustments are shown on this statement after the determination of net income from regular operations. These changes allow a more meaningful comparison of the results of ordinary Loan Program operations for the 3 years. The scope of our audit is shown on page 51, and our opinion of the financial statements is shown on page 52.

REALIZABLE VALUE OF LOAN PROGRAM ASSETS UNDETERMINABLE

The assets of the Loan Program are shown in the June 30, 1964, Statement of Financial Condition at their full face value at that date. No allowance has been made for future losses which may be sustained on loans and interest receivable. This policy, which is explained by the Agency in footnote 4 to the financial statements, has been adopted by AID because of the absence of an experience factor on which to estimate possible future losses in administering the Loan Program.

The experience of AID in conducting the Loan Program from November 1961 through June 30, 1964, has shown that there are a number of factors that make undeterminable the realizable value of the loans receivable balances, the foreign currency cash balances, and, to a lesser extent, certain of the other assets shown on the Statement of Financial Condition.

One of the factors which has a direct effect on the realizable value of Loan Program assets is the fluctuation in the foreign currency exchange rates. Substantial exchange rate losses have been incurred over the past 3 years. We believe that it is reasonable to expect that this experience will be repeated to some degree in the future. Other factors which indicate that the full face value of Loan Program assets may not be realized include the fact that AID has (1) eliminated maintenance-of-value provisions from loan agreements, (2) converted loans to grants, (3) classified a number of loans as being delinquent, (4) deferred other loans in order to postpone repayments, and (5) other loans that are in dispute as to the proper exchange rates. Each of these factors is discussed in more detail below.

Exchange rate losses

At June 30, 1964, AID records showed that the net aggregate exchange rate loss incurred by the Loan Program after AID was established in November 1961 amounted to the dollar equivalent of $351.2 million. Such losses are the result of declines in the value of foreign currency monetary units in relation to the dollar and consist of (1) the loss in value of loans and interest which are repayable in foreign currency without maintenance-of-value provisions, (2) the loss in value of foreign currency cash balances in the AID Loan Program accounts, and (3) the exchange rate losses incurred in foreign currency transactions carried out under the Loan Program. Some of the more extreme examples of declines in the values of foreign currency units, in relation to the dollar, which have affected Loan Program assets during a 2-1/2-year period include Indonesia, where the value of the rupiah declined 91 percent; Brazil, where the value of the cruzeiro declined 70 percent; and Chile, where the value of the escudo declined 67 percent.

The dollar value of foreign currency assets on the June 30, 1964, Statement of Financial Condition represents the value of these assets as computed in accordance with regulations and rates of exchange issued by the Treasury Department for that date. A substantial part of these foreign currency assets consists of loans and interest receivable which are repayable in foreign currency without maintenance-of-value provisions over a time period extending from fiscal year 1965 through fiscal year 2004. Another substantial part of foreign currency assets of the Loan Program consists of foreign currency cash balances which are subject to fluctuations in value even before they are disbursed as loans. On the basis of the experience of AID through fiscal year 1964, we believe that it is reasonable to expect that additional substantial exchange rate losses on foreign currency assets will be sustained in the future.

Elimination of maintenance-of-value provisions from loan agreements

AID amended six loans in fiscal years 1963 and 1964 that eliminated the maintenance-of-value provisions. These loan agreements totaled $158.8 million and were originally entered into in 1956, 1958, and 1959 with three countries under authority of section 104(g) of Public Law 480. Because of the sharp decrease in the value of the monetary units of these countries over the past several years, the elimination of the maintenance-of-value provisions from the six loan agreements resulted in an immediate exchange rate loss of $91.7 million.

In commenting on this matter, the Agency suggested that our report indicate that political or other considerations were taken into account in elimination of the maintenance-of-value provisions. It is not our purpose in this report to question the Agency's decision on the elimination of these provisions from certain loan agreements; however, we believe that this matter clearly illustrates one of the many factors that can affect the ultimate realizable value of the outstanding loans.

Conversion of loans to grants

As disclosed by the Agency in footnote 4 to the financial statements, AID converted $2.3 million of dollar repayable loans to grants in fiscal year 1964. These conversions involved (1) a loan made in fiscal year 1961 to a charitable organization for $1 million of which $30,000 was repaid and $970,000 was converted to a grant when it became apparent that the borrower was unable to meet the loan installments and (2) a loan made in fiscal year 1957 to a government for $3.5 million of which $1,366,300 was converted to a grant after the government asserted that excessive costs were being incurred in the construction of a power project because of the use of United States contractors on the job.

In commenting on our report, the Agency set forth the program and foreign policy considerations underlying its decision to convert the subject loans to grants. It is not our purpose to question the Agency's decisions in these two cases; however, we believe they illustrate one of the many factors that can affect the ultimate realizable value of the outstanding loans.

Delinquent loans and interest

At June 30, 1964, AID's records showed that there were 39 loans with an outstanding balance of $123.3 million in a delinquent status on which \$4.7 million in principal and \$4.9 million in interest were overdue. The periods of delinquency ranged from a few days to 36 months. One of the delinquent loans with an outstanding balance of \$212,900, to a commercial enterprise in a foreign country, has been referred to the Department of Justice for whatever action deemed appropriate after AID had made extensive efforts to effect collection. Although AID had not written off as uncollectible any loans made under its administration, the records indicate that there is the possibility that such action may be necessary in the near future.

Deferred loans and interest

At June 30, 1964, there were five loans totaling $286.2 million for which payments of principal and interest had been deferred. The deferral plan consists of the postponement of a specified number of payments to dates following the original terminal payment date. No repayments of principal or payments of interest are to be made during the deferral periods which range from 8 to 10 years. Because of the nature of the AID loan program, it appears reasonable to expect that similar deferrals will need to be made in the future.

Disputed exchange rates

At June 30, 1964, AID had in its accounts the dollar equivalent of $4,056,755 in the currency of one country, which had been received as loan repayments and interest payments at rates of exchange unacceptable to AID. These disputed payments had been received from fiscal years 1960 through 1964 in payment of billings in the dollar equivalent of $8,309,597 on three loans repayable in local currency with maintenance-of-value provisions. These loans were made in fiscal years 1957 and 1958 under authority of the Mutual Security Act of 1954 and were funded from dollar appropriations.

In the past, several disputes over proper exchange rates had been resolved in favor of the borrowers. Therefore, although at the time of our audit AID believed that its interpretation of the maintenance-of-value provisions for the three loans was correct and it had not accepted the payments tendered, we expressed the view that the possibility existed that the total value ultimately realized on these loans might be considerably less than the values shown for these loans on the June 30, 1964, Statement of Financial

Condition. Subsequent to our audit, this matter was resolved in favor of the borrower, as discussed in the footnote on page 25.

Conclusion

We believe that it is not possible to make a reasonable determination of the realizable value of the assets of the Loan Program. The greater part of the assets consists of outstanding loans which are not scheduled for repayment for a considerable length of time--in some instances as long as 40 years. Also, a substantial part of the assets consists of foreign currency cash balances and loans and interest receivable which are repayable in foreign currency without maintenance-of-value provisions and which are not freely convertible to United States dollars. The foreign currencies on which these assets are based include several that have had a recent history of sharp declines in value. Some of the factors which may adversely affect the assets of the Loan Program have been enumerated in this section of the report. We believe that these factors will substantially affect the realizable value of the assets, but it is not possible to estimate their effect with the degree of accuracy necessary to establish a meaningful allowance for future losses.

OVERSTATEMENT OF NET INCOME DUE TO
EXCLUSION OF ADMINISTRATIVE EXPENSES

The net income shown on AID's Statements of Income and Expense for the Loan Program for each of the fiscal years 1962, 1963, and 1964 is materially overstated since it was determined without considering the administrative expenses incurred in conducting the Loan Program for those years.

AID's total administrative expenses for the 3 years included both the general and administrative appropriations of over $50 million each year and the payment from other appropriations that are not included in the Statements of Income and Expense for the Loan Program for certain technical personnel engaged in administering AID's programs in the field. We did not examine into the extent to which administrative expenses, including the services of field personnel, are devoted to the Loan Program. We believe, however, that the extent is very substantial since, as shown by the accompanying financial statements, the Agency must service a total United States investment in loan capital that amounted to $11.2 billion at the end of fiscal year 1964 that had increased by over $1.5 billion in each of the 3 fiscal years and that consisted of $7.4 billion of loans outstanding at that date and about $3.8 billion available to fulfill prior commitments and to make new loans.

The Statements of Income and Expense for fiscal years 1962, 1963, and 1964 include only a portion of the costs of conducting the Loan Program. These costs include a relatively small amount of interest on borrowings from the Treasury, fees of the Inspector General of the Department of State, certain foreign currency costs incurred in connection with the administration of the Public Law 480 Loan Program, and exchange rate losses. Administrative expenses which are funded from a general and administrative appropriation for the entire Agency are not included, as AID follows the practice of not allocating overall Agency administrative expenses to each of the programs under its administration. This practice is disclosed in footnote 6 to the financial statements.

The reported net income of the Loan Program before extraordinary charges was $67.8 million in fiscal year 1962, $19.6 million in fiscal year 1963, and $129.2 million in fiscal year 1964. The overall administrative expenses funded by AID from the general and administrative appropriation in conducting all programs were

$54.7 million in fiscal year 1962, $53.3 million in fiscal year 1963, and $53 million in fiscal year 1964. Since, as indicated above, the Loan Program is a major activity of AID, a significant part of total administrative expenses would have been attributable to this program and, if applied, the net income reported for each of the 3 fiscal years would have been substantially less than that actually reported. It is possible that a net loss would have been reported for fiscal year 1963.

We believe that the exclusion of a significant element of cost of conducting the Loan Program--administrative expenses--has resulted in a material overstatement of net income for each of the 3 fiscal years. Although footnoting the financial statements does alert the reader to this departure from generally accepted accounting principles, we do not agree that it is an acceptable alternative.

We proposed to AID that, in order to provide more meaningful information on the overall results of Loan Program operations, an integral set of accounts be maintained which provides for the allocation of administrative expenses to the Loan Program and that these expenses be included in future Statements of Income and Expense.

Agency comments

In commenting on this matter, AID expressed disagreement with our proposal. The Agency has advised us that it already compiles administrative costs by organization and by funding source and that, although it is possible to compile such costs on the basis we suggested, it is AID's view that no significant management purpose would be served.

We do not agree with the Agency's position for the following reasons.

1. The loan program is one of the major activities of the Agency, and, although there is no legislative requirement that it be operated on a profit or break-even basis, we believe that Agency management, the Congress, and the public should be fully informed as to the financial operating results of the Loan Program. The fact that the rate of interest the Agency must charge on loans was increased by the Congress in both 1963 and 1964 can be related to congressional interest in Loan Program costs.

2. Cost information provides a common financial denominator for the measurement and evaluation of efficiency and economy in terms of resources used in performance.

3. The appropriate matching of revenues and costs is one of the basic precepts of accounting. The failure to include all operating costs of the Loan Program in the financial statements is contrary to this precept and does not result in full disclosure of the results of Loan Program operations. By letter dated July 10, 1963, the Commissioner of Accounts of the Treasury Department took a similar position. In that letter, addressed to an Agency accounting official, the Commissioner of Accounts stated, in part, that:

> "*** Most of the administrative expenses applicable to loan programs are not presently shown on the financial statements, since these expenses are paid from general appropriations made available to AID and are not apportioned to programs. Although AID feels that the apportionment of these expenses is not feasible, the Treasury feels that the matter should be held open for future discussion since, <u>without full disclosure of such expenses the financial statements are incomplete</u>. ***" (Underscoring supplied.)

4. The Budget and Accounting Procedures Act of 1950 (31 U.S.C. 66a) requires that the head of each executive agency shall establish and maintain systems of accounting and internal control designed to provide, among other things, full disclosure of the financial results of the agency's activities. Pursuant to that act, the accounting principles and standards prescribed by the Comptroller General for Federal agencies provide, among other things, that, to meet (1) the statutory objectives of full disclosure of the financial results of agency activities, (2) the production of adequate financial information for agency management purposes, and (3) support of budget justifications with performance and cost data, the accounting system must provide for the systematic accumulation of cost information by major organizational segments and by budget programs or activities. The principles and standards provide also that agencies carrying on business-type activities should prepare statements of operations disclosing revenues and costs.

5. Section 635(g)(5) of the Foreign Assistance Act of 1961 provides that, in making loans under the act, an integral set of accounts shall be maintained. We believe that an integral set of accounts for an activity such as the Loan Program should include accounts relating to all sources of funds used to finance the activity.

Recommendation

Accordingly, we recommend that, in order to provide more meaningful information on the overall results of Loan Program operations, an integral set of accounts be maintained which provides, among other things, for the allocation of administrative expenses to the Loan Program and that these expenses be included in future statements of income and expense.

OVERSTATEMENT OF ASSETS BY $81 MILLION
DUE TO OVERVALUATION OF CERTAIN LOANS

Seven loans and a part of two other loans to one country have been incorrectly classified by AID in the financial statements as loans having maintenance-of-value provisions. As a result, the value of the monetary unit of the borrowing country was not a consideration in determining the value of the outstanding loan balances and the accrued interest on these loans, thereby causing the loans receivable and accrued interest receivable balances shown on the June 30, 1964, Statement of Financial Condition to be overstated by $79.6 million and $1.4 million, respectively. Interest income and the net exchange rate losses reported in the Statements of Income and Expense for fiscal years 1962, 1963, and 1964 were also significantly affected.

The original loan agreements for the nine loans, which were made during the period 1956 to 1959, provided that payments of principal and interest could be made in dollars or in local currency with maintenance-of-value provisions. In December 1960 the agreements were amended to provide that, if payments were made in local currency, a fixed rate of exchange would be applied for seven of the loans and a part of the other two. In effect, these amendments eliminated the maintenance-of-value provisions on these loans. Since the rates of exchange fixed in the amended loan agreements--475 and 525 units to $1--are substantially less than the Treasury Department prescribed rate at June 30, 1964--750 units to $1--the values of the outstanding loan balances and interest receivable were actually $81 million less than the amounts included in the June 30, 1964, Statement of Financial Condition.

If these nine loans had been properly treated as loans not carrying maintenance-of-value provisions, the $79.6 million decline in the value of the outstanding balance would have been recognized and recorded as exchange rate losses in the periods the losses actually occurred. We have determined that the losses should have been recognized in fiscal year 1961, prior to the establishment of AID. Inasmuch as the losses were not recognized, the Investment of the United States Government was overstated at the time AID was established, and, since no correction had been made, the Investment balance on the June 30, 1964, Statement of Financial Condition was still overstated.

AID's practice of treating the nine loans as loans having maintenance-of-value provisions has resulted in overstatements of reported interest income by $1.5 million for fiscal year 1962, $3 million for fiscal year 1963, and $4.2 million for fiscal year 1964. These overstatements were caused by the application of interest rates to the inflated loan balances in the determination of accrued interest and interest income.

AID's accounting treatment for these loans also resulted in an understatement of net exchange rate losses reported for fiscal year 1962 by $5.9 million and in overstatements of net exchange rate losses reported for fiscal years 1963 and 1964 by $2 million and $2.6 million, respectively. These misstatements resulted from (1) recording exchange rate gains to account for the difference in value of the local currency loan disbursements as determined in accordance with the fixed rates of exchange specified in the loan agreements and with the higher rate of exchange prescribed by the Treasury Department and (2) recording exchange rate losses to account for the difference in value of the local currency receipts of interest and principal as determined in accordance with the rate of exchange prescribed by the Treasury Department and the corresponding inflated values at which the interest due and the outstanding loan balances are shown in the accounting records. For financial reporting purposes, exchange rate gains are offset against exchange rate losses and the net amount is reported as "net exchange rate losses" in the Statement of Income and Expense.

If these loans had been originally classified by AID as loans without maintenance-of-value provisions, no exchange rate gains or losses would have been incurred after AID was established in November 1961 because the rate of exchange prescribed by the Treasury Department for the monetary unit of this particular country has remained constant. In effect, AID's accounting practices for these loans result in the unwarranted exchange rate gains recorded when loan funds are disbursed and in the overstatements of the outstanding loan and interest balances being absorbed as exchange rate losses when principal and interest payments are received.

We were informed by officials of the Office of the Controller that, although our viewpoint had merit from an accounting principle standpoint, their treatment of these loans was justified from an administrative standpoint. In support of their position, the AID officials have pointed out that the nine loans differ from regular loans repayable in local currency without maintenance-of-value provisions in that these loans are denominated in dollars rather than in local currency and that the borrowing country does have the option of repaying these loans in dollars. Since the loans are denominated in dollars, the International Loan Branch must maintain the accounting records on the loans in terms of historical dollar values for billing purposes. If the nine loans were to be considered as non-maintenance-of-value loans, it would be necessary to segregate them for special handling in order to prepare financial statements, or duplicate sets of loan records would have to be maintained--one set for billing purposes and another set for financial statement purposes. They stated that it was their opinion that the benefits of adopting either of the alternatives did not justify the additional work involved.

We do not agree that the reasons advanced by AID justify the classification of these loans as maintenance-of-value loans in the financial statements with the resultant overstatement of Loan Program assets at June 30, 1964, by $81 million and the distortion of interest income and net exchange rate losses reported for each of the 3 fiscal years. The existing loan agreements do not include maintenance-of-value provisions in that the value of the local currency unit in relation to the dollar is permanently fixed in the loan agreements for the full term of the loans. We believe that loans repayable in local currency at specific fixed rates of exchange are non-maintenance-of-value loans, and, as such, the outstanding loan balances and the accrued interest thereon should be revalued for financial statement presentation at the applicable rate of exchange prescribed by the Treasury Department. Although the borrowing country does have the option of repaying the seven loans and a part of the other two loans in dollars, no payments in dollars have been made to date and it is very unlikely that the borrower will exercise this option in the future in view of the apparent advantage of repaying the loans in depreciated local currency.

Therefore, we suggested to AID that the seven loans and the appropriate part of the other two loans, as well as any other loans repayable in local currency at fixed rates of exchange, be classified and accounted for as loans without maintenance-of-value provisions for financial reporting purposes.

In commenting on this matter, AID advised us that it agreed in principle with our suggestion and that it was investigating the most practical approach to take in order to report the status of the loans as we suggested.

PREMATURE RECOGNITION OF $4.2 MILLION IN EXCHANGE RATE LOSSES ON FOREIGN CURRENCY RECEIPTS IN DISPUTE

Our opinion, based on our review, is that AID prematurely recognized exchange rate losses of $4.2 million, thereby understating net income for fiscal year 1962 by $1.6 million, for fiscal year 1963 by $1.3 million, and for fiscal year 1964 by $1.3 million. AID has adopted the policy of valuing foreign currency receipts, which are in dispute as to the proper exchange rate, at the rates of exchange claimed by the borrower (35 to $1) instead of the rates of exchange prescribed by the Treasury Department (73.5 to $1). This practice affects net income for the years in which the disputed payments were received since the differences in the values of the payments as claimed by the borrower and as calculated in accordance with Treasury Department prescribed exchange rates are recorded as exchange rate losses. The disputed payments have been received on three loans to one country that are repayable in local currency with maintenance-of-value provisions. AID's accounting treatment of the accrued interest on these loans is discussed separately, beginning on page 29.

AID does not apply disputed payments to the principal and interest installments due from the borrower but shows such payments on the Statement of Financial Condition as "Unapplied Credits."

Since the payments are valued at the rates of exchange claimed by the borrower, the balance in "Unapplied Credits" is overstated at June 30, 1964, by $4.2 million, and, because of the understatements of net income for each of the 3 fiscal years, "Accumulated Net Income" shown on the Statement of Financial Condition is correspondingly understated by $4.2 million.

On the basis of our review of the three loan agreements, we agreed with AID's contention that the borrower had not complied with the maintenance-of-value provisions in the agreements and that AID was fully justified in demanding additional payments. However, we did not agree with AID's practice of recognizing the exchange rate loss on disputed payments when they were received. As long as the dispute remains unresolved, we believe that the payments should be held in the suspense account, "Unapplied Credits," at values determined in accordance with Treasury Department rates of exchange for the periods in which the payments were received.[1]

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[1] In July 1965, subsequent to the completion of our audit, an agreement was reached with the recipient country whereby payments of principal and interest prior to January 1, 1965, were accepted by the United States at the exchange rate claimed by the borrower (i.e., 35 local currency units to $1). As a result, the local currency on deposit amounting to the dollar equivalent of $4,056,755 was accepted as a complete payment of billings which had a dollar equivalent value of $8,309,597. The difference of $4,252,842 therefore becomes a realized exchange rate loss as a result of the agreement. The agreement provided also that payments of principal and interest after January 1, 1965, would be made at the exchange rate of 73.5 local currency units to $1 as long as this rate is applied to official purchases of the borrower's local currency made by the United States Government.

In a discussion with officials of the Office of the Controller, we were informed that consideration would be given to adopting our view on the valuation of payments held as "Unapplied Credits." Subsequently, in commenting on this report, AID took the position that its accounting treatment of these transactions was in accord with procedures prescribed by the Treasury Department, as modified by a special waiver granted to AID. Based on our review of the special waiver granted to AID by the Treasury Department, our opinion is that the waiver is not related to AID's accounting treatment of these transactions.

Recommendation

Accordingly, we recommend that foreign currency payments held as "Unapplied Credits" be valued at rates of exchange prescribed by the Treasury Department and that exchange rate losses be recognized by the Loan Program only when an exchange rate dispute is resolved in favor of the borrower.

ACCOUNTING ERRORS AND DEFICIENCIES IN ACCOUNTING RECORDS

Our audit of the financial statements disclosed a number of accounting errors which in total, and in a few cases singly, materially affected the fairness of certain balances shown in the statements. Our audit also disclosed deficiencies in accounting records which hampered us in analyzing certain balances and transactions. The more serious errors and deficiencies in accounting records are discussed below.

Errors in derivation of "funds available from other A.I.D. appropriations"

Our review of "funds available from other A.I.D. appropriations" in dollars, a Loan Program asset, disclosed several errors in the data used to derive the balance as of June 30, 1964, for financial statement presentation. These errors resulted in an overstatement of this asset and the balance shown for the investment of the United States in the Statement of Financial Condition. In addition, the accounting records supporting one part of the final balance were such that a complete analysis could not be made without a disproportionate amount of audit effort.

"Funds available from other A.I.D. appropriations" in dollars represents the undisbursed portion of loan agreements which are to be funded from multipurpose appropriations. Such appropriations are available to AID for disbursement as grants as well as loans. The annual appropriation for supporting assistance under section 401 of the Foreign Assistance Act of 1961 is an example of a multipurpose appropriation. Our review disclosed that the International Loan Branch does not maintain a continuous record on the status of "funds available from other A.I.D. appropriations."

Instead, at the close of the fiscal year, the balance is derived from the fiscal data pertaining to the loans which are funded from multipurpose appropriations. In our attempt to reconcile this data with the corresponding cash balances available to fund the undisbursed portion of these loans, we found that one part of the final balance amounting to about $34 million could not be completely analyzed without a disproportionate amount of audit effort. This part of the final balance consisted of the undisbursed portion of loans originally made prior to the establishment of AID in 1961. Our selective review of the larger loans in this category disclosed the following discrepancies in the accounting records.

	Undisbursed loan balances per data used to compile total "funds available from other A.I.D. appropriations"	Total available funds per fund control records
	(millions)	
Loan A	$ 4.6	$ 3.0
Loan B	9.9	6.4
Loan C	5.0	3.7
Loan D	7.2	-
Total	$26.7	$13.1

On the basis of the accounting records reviewed by us for the four loans listed above, we have concluded that the balance shown on the Statement of Financial Condition as "funds available from other A.I.D. appropriations" in dollars is overstated by $13.6 million. The investment of the United States Government is correspondingly overstated.

Also, we noted that an error had been made in the final summarization of the total balance. The undisbursed portion of one group of loans totaling $95.7 million was erroneously included in the final balance while the undisbursed portion of a second group of loans totaling $115.5 million was erroneously excluded. As a result, the balance shown for this asset in the financial statements prepared by AID for the Treasury Department was understated by $19.8 million. We brought this error to the attention of Agency personnel and a correction was made before the financial statements used in this report were finalized.

The other discrepancies in the accounting records and the general inadequacy of certain of these records were discussed with appropriate officials of AID. The officials stated that they were aware of the deficiencies in the supporting records for this account, but, because of other pressing matters in the International Loan Branch, the project of completely analyzing and correcting these records had not been undertaken.

In commenting on this report, the Agency stated that, insofar as actual obligations were concerned (as opposed to undisbursed mutual security lines of credit), ample funds were reserved and on hand. The Agency stated also that the problem was being resolved as the lines of credit were being liquidated. These comments do not dispute our report point that, on the financial statements being audited, the total balance shown for the asset is inflated when compared with the available supporting records.

<u>Interest income of $5.6 million erroneously eliminated from the accounting records</u>

AID erroneously eliminated from the accounting records $5.6 million of interest income on three loans which were in dispute over proper exchange rates. These errors resulted in understatements of reported net income for fiscal years 1963 and 1964 and an understatement of accrued interest receivable by $5.6 million on the June 30, 1964, Statement of Financial Condition.

Repayments made by one country on three loans have been made at rates of exchange unacceptable to AID since 1960, and, in accordance with established policy on such payments, AID has not applied these payments against the principal and interest due but has recorded them in the suspense account, "Unapplied Credits." AID's accounting treatment of the amounts recorded in "Unapplied Credits" is discussed separately beginning on page 24.

Our review disclosed that the data on total accrued interest, which was prepared at the close of fiscal year 1964 for financial statement purposes, included only the interest accrued on the three loans since the date of the receipt of the last unacceptable payment. A total of $5.6 million of interest accrued prior to that date, which remained unpaid because payments acceptable to AID had not been received, was not included in the final total used in the Statement of Financial Condition at June 30, 1964. Because the erroneous data on accrued interest were also used in the determination of interest income, the Statements of Income and Expense were also affected. We determined that interest income was understated by $3 million for fiscal year 1963 and by $2.6 million for fiscal year 1964.

We brought these errors to the attention of supervisory personnel of the International Loan Branch. They agreed that the errors had been made and stated that they had been caused apparently by a misunderstanding on the part of the employee who prepared the data on accrued interest at the close of the fiscal year.

In commenting on this aspect of our report, AID stated that it did not believe that the principle of adequate disclosure is served by including as interest income in the financial statements an amount of accrued interest due which is disputed by the borrower. AID stated also that it had no unilateral right under the terms of a maintenance-of-value loan agreement to determine the effective exchange rate on any transaction and that, inasmuch as the borrower in good faith had made payments which discharged his obligation under the borrower's interpretation of the loan agreement, consistent accounting treatment demands that the entire transaction be held in suspense until resolved.

Our audit work indicated, and AID accounting personnel agreed, that the accrued interest being discussed had been eliminated because of an error in computation; although, in commenting on our report, AID implied that the accrued interest was eliminated because of its accounting policy. In any event, we do not agree with AID's accounting treatment of this item for the following reason.

The Accounting Principles and Standards for Federal Agencies prescribed by the Comptroller General require that, under the accrual basis of accounting, receivables representing amounts due from others are accounted for as assets from the time the acts giving rise to such claims are collected, converted into other resources, or determined to be uncollectible. In the case at point, AID had not determined the receivable to be uncollectible; therefore, we believe that the accrued interest receivable and the related interest income should have been included in the financial statements.

Additional errors in computation of interest accruals

In addition to disclosing the errors on the three loans discussed above, our testing of interest accruals at June 30, 1964, disclosed 21 other errors which directly affected the accrued interest receivable balances shown on the June 30, 1964, Statement of Financial Condition and the interest earned balances shown on the Statement of Income and Expense for fiscal year 1964. These errors ranged up to $1.4 million and consisted of 10 understatements of accrued interest totaling $2,401,000 and 11 overstatements of accrued interest totaling $334,000. The causes for these errors included (1) the omission of all or part of the accrual on a particular loan from the compilation of total accrued interest, (2) the accrual for a particular loan twice in the compilation while omitting the accrual on another loan altogether, (3) adding an interim memorandum computation of accrued interest on a particular loan to the June 30 computation, and (4) erroneous mathematical computations. Our reviews of the data supporting accrued interest at June 30, 1962 and 1963, also disclosed a number of errors which affected the financial statements for those fiscal years.

Loan funds are generally disbursed over a considerable period of time, and therefore, the determination of accrued interest at a particular date for many of the loans involves several computations. Our review of the interest accruals compiled for use in the financial statements consisted of a detailed examination of the interest computations for a selected number of loans. On the basis of the extent of the errors disclosed in our test and the general inadequacy of internal control procedures to minimize errors in interest accruals, we do not believe that the data prepared by AID is reliable enough to adequately support the interest balances shown on the Statement of Financial Condition and the Statements of Income and Expense.

Interest for most loans administered by AID is due semiannually, and individual billings are prepared and sent to the borrowers throughout the year. Therefore, the errors disclosed during our review of the interest accruals as of June 30 do not necessarily indicate that the interest billed and collected for the loans involved was also incorrect.

Other transactions not properly recorded

We noted a number of instances where other transactions had not been recorded properly in the Loan Program accounting records. Some of these errors which affected several balances shown on the financial statements for fiscal year 1964 are discussed briefly below.

1. AID recorded a transfer of foreign currency to the Treasury Department at an improper exchange rate, resulting in an overstatement of net income for fiscal year 1964 by $426,000. The Investment of the United States Government was also affected. This error was caused by valuing a transfer of foreign currency to the Treasury Department at the rate of exchange in effect during the quarter when the transfer was authorized instead of the rate of exchange in effect for the quarter in which the transfer was actually made. Since the rate of exchange for the particular currency in question declined substantially in the two quarters, the application of the improper rate resulted in an overstatement of net income on the Statement of Income and Expense for fiscal year 1964 by $426,000 because of the understatement of the exchange rate loss incurred while these funds were actually assigned to AID. We were informed that this matter would be corrected.

2. Three payments totaling $768,000 were received prior to the close of fiscal year 1964 but were not recorded as being received until fiscal year 1965. Two of the payments were received by AID missions, and in both cases AID/Washington headquarters was notified by cablegram that the payments had been received prior to June 30, 1964. In the other case, the payment was received in June 1964 by AID/Washington headquarters. The failure to record these collections as fiscal year 1964 transactions resulted in an

understatement of the cash balance and an overstatement of the loans and interest receivable balances shown on the June 30, 1964, Statement of Financial Condition.

In commenting on this item, AID stated that, where the amount was not received by the Treasury until after the close of the fiscal year, AID did not record the amount on its records until the latter period so as to remain in balance with the Treasury. This position is contrary to AID's general practice since, as can be seen on page 56, AID did record $3.1 million as cash in transit at June 30, 1964. Also, this position is contrary to the Accounting Principles and Standards for Federal Agencies prescribed by the Comptroller General.

3. The accounting records indicate that two foreign currency collections, valued at $493,000, were received in fiscal year 1962 on loans to one country but had never been recorded in the Loan Program accounting records. These payments, which were made at rates of exchange unacceptable to AID, should have been recorded as "Unapplied Credits." The failure to properly account for these collections was brought to the attention of appropriate agency personnel in October 1963, and corrective action was promised. However, our subsequent review at June 30, 1964, showed that the collections still had not been recorded nor had the matter been otherwise resolved.

AID informed us that this matter would be corrected as of June 30, 1965.

4. When three loan agreements with a country were amended to delete the maintenance-of-value provisions in fiscal year 1964, AID transferred the account balances pertaining to these loans to the non-maintenance-of-value accounting records. In reviewing this

transfer we noted that, apparently, about $782,000 more was transferred to the accounting records for non-maintenance-of-value loans than had been transferred from the accounting records for maintenance-of-value loans. We were informed by personnel of the International Loan Branch that they were aware that a discrepancy existed but that they had been unable to find the error or errors in their attempt to reconstruct the data on these loans.

AID informed us that this matter would be corrected as of June 30, 1965.

5. In order to agree with a Treasury Department report on a particular cash account, AID adjusted its records in fiscal year 1964 by increasing its cash balances by $181,000 and setting up a general account payable in the same amount. Subsequent information obtained in fiscal year 1965 showed that the Treasury Department report had been in error and that no adjustment should have been made by AID.

AID, in commenting on this point, took the position that the entry did no harm to the accounts of either agency and was considered most economical since it relieved the Treasury of the necessity of reopening its accounts and of revising innumerable reports. We do not agree with AID. Insofar as AID's loan program accounts are concerned, its cash balance was knowingly overstated by $181,000. In our opinion, the principle involved is of far greater significance than the amount involved.

6. Several transactions recorded during fiscal year 1964 were improperly classified as to whether they were foreign currency transactions or dollar transactions. As a result, certain line items in the financial statements are overstated and others are understated. Total balances shown in the statements were not affected by these misclassifications.

At the conclusion of our audit, we addressed a letter to AID summarizing a number of accounting matters not specifically commented on in this report. These matters related to (1) inadequate verification of account balances, (2) improper prior-year adjustments, and (3) lack of prompt deposits in the Treasury.

PROPOSALS AND AGENCY ACTION

At the conclusion of our audit we proposed to AID that:

1. A comprehensive review of the Loan Program accounting system be made by the Accounting Systems Staff of the AID Controller.

    a. The review include the preparation of written formalized accounting procedures and instructions.

    b. The necessary procedural, staffing, and equipment changes indicated by the review be made.

2. In the interest of achieving and maintaining a sound accounting system and improving internal control, future periodic audits of the accounting for the Loan Program be made by the Internal Audit Branch.

AID informed us that it agreed that a comprehensive review of the Loan Program accounting system should be accomplished, and we understand that AID is in the process of obtaining professional assistance from outside the Government, looking toward the development of a comprehensive loan accounting system which will be responsive to the principles and standards prescribed by the Comptroller General and which will permit mechanization through the use of electronic data processing equipment. AID informed us also that, in the future, it plans to have its internal audit staff periodically schedule audits of the accounting for the Loan Program.

OVERALL AGENCY COMMENTS

Our report was referred in draft form to the Agency for review and comment, and the Agency's comments were furnished to us by letter dated August 18, 1965. (See appendix 6.) After our review and evaluation of the Agency's comments on specific matters, these comments, where considered appropriate, have been referred to in the specific sections of the report to which they were directed. In addition, the Agency stated its overall position on our report as follows:

> "*** we disagree with a number of the underlying premises and generalized statements in the report. First, although the General Accounting Office is required by Section 635(g) of the Foreign Assistance Act of 1961 to audit our loan programs in accordance with the Government Corporation Control Act, it is clearly evident it was not Congressional intent that the loan programs of A.I.D. should be operated as a self-sustaining government corporation. Nor was it intended that these loan programs be operated on a profit or a "break-even basis." Loans made by A.I.D. and its predecessor agencies generally have been made under the "lender of last resort" concept. Loans are authorized on concessional terms for economic purposes in developing countries in support of the foreign policy objectives of the United States. It follows, therefore, that our main purpose in maintaining the loan accounting system has been that of (a) insuring proper stewardship of the U.S. resources made available for authorized loan programs, and (b) facilitating effective execution and servicing of loan agreements. The draft report in its present form conveys the impression that loan accounting is primarily for the purpose of preparing yearly financial reports which will permit certification and use as a corporate or "banker's type" statement. We believe you will agree with us that A.I.D. should not maintain accounts primarily for the purpose of reflecting the financial condition of an arbitrarily-established entity, but to serve management's needs. It is important that the report recognize these concepts so that the Congress and other readers of the report will not be mislead."

Analysis of Agency comments

The underlying premises of our report are not, as implied by the Agency, that the Loan Program should be operated as a self-sustaining government corporation on a profit or break-even basis, or to produce yearly "banker's type" financial reports that permit certification. Rather, our position is that AID's financial statements should completely and accurately disclose its current financial condition and results of operations and that the supporting accounting system should provide reliable and complete information needed for the effective discharge by AID of its internal and external financial management responsibilities. Although we agree with AID that the accounting system should serve management's needs, we cannot agree that such needs are adequately served by the present system which is limited largely to accounting in terms of fund source (type of loan) and agency organizational elements and which is otherwise unreliable in significant respects. Management's needs for financial information and control are further discussed in the following section of this report.

COMMENTS ON CURRENT NEED FOR IMPROVEMENTS IN ACCOUNTING AND FINANCIAL MANAGEMENT

Although fiscal year 1964 is the latest period covered by the accompanying financial statements, the basic deficiencies and underlying causes to which we direct our recommendations continue into the current fiscal year. Significant allocable administrative costs are excluded from the Loan Program accounting and financial management reporting system. The Loan Program accounts and the data reported and recorded are in significant respects unreliable, the accounting system does not generate certain data required for effective financial management, and adequate internal controls, written procedures, and internal audits are lacking.

The Budget and Accounting Procedures Act of 1950 provides that the accounting systems of the executive agencies shall conform to the principles, standards, and related requirements prescribed by the Comptroller General. Among other things, the principles and standards prescribed by the Comptroller General provide that:

1. Agencies should prepare statements of assets and liabilities relating to their programs or activities. (2 GAO 17.2.)
2. Agencies carrying on business-type activities should prepare statements of operations disclosing revenues and costs. (2 GAO 17.2.)
3. Agencies are to maintain a suitable system of financial and related records from which needed information on resources, liabilities and obligations, expenditures, revenues, and costs can be obtained and reported for the information and control use by appropriate levels of management; other agencies and authorities having control responsibilities; Congress; and utlimately the public. (2 GAO 6.)

The preferred accounting structure for Federal agency activity is one in which accounts relating to all funds regardless of source used in financing such activities are incorporated in an integrated accounting system together with the application of all resources to the Agency's program purposes. Such systems are necessary to enable agencies to provide themselves with current, reliable data on which to conduct their affairs and to be able to report the cost of a program to the Congress and to other agencies concerned with their activities.

The Loan Program is a large business-type activity and is one of the major activities of AID. As an entity having the single function of financing the various purposes of AID, it is particularly suited to an integrated accounting system and to business-type financial statements reflecting the financial condition and results of operations of the activity as a whole. Although the agency must maintain appropriate detail accounts to control the various funds available for financing loans and to ensure compliance with applicable limitations or restrictions, it is our view that overall business-type statements on the entire Loan Program are necessary and desirable to keep the Congress and the public adequately informed as to the costs, financial condition, and operating results of such a large activity and to comply with the intent of the Budget and Accounting Procedures Act of 1950 and the related principles and standards prescribed by the Comptroller General.

In addition to the above, section 635(g)(5) of the Foregin Assistance Act of 1961 requires, in making loans under that act, the maintenance of an integral set of accounts which shall be audited by the General Accounting Office in accordance with principles and procedures applicable to commercial corporate transactions as provided by the Government Corporation Control Act. The legislative history of this section of the act does not clearly show whether the Congress intended that all the loans administered by AID would be subject to this requirement. In the act, however, the Congress specifically provided for the consolidation of foreign assistance lending in AID. Among other things, the act abolished the corporate Development Loan Fund and transferred its loan activities to AID; abolished the International Cooperation Administration and transferred its loan activities to AID; and transferred certain foreign currency loan functions from the Export-Import Bank to AID.

The present accounting system is not in accord with the accounting principles and standards prescribed by the Comptroller General. The principal weaknesses, described in the preceding section of this report, in terms of their effect on the Loan Program financial statements are further amplified below from the standpoint of financial management needs.

EXCLUSION OF SIGNIFICANT
ALLOCABLE ADMINISTRATIVE COSTS

As shown on page 15, AID's administrative expenses are significant and are devoted to the administration of the Loan Program to a substantial extent. Much of AID's administrative expenses consist of personal service costs and appurtenant costs such as travel, and thus involve manpower utilization. Manpower is a principal agency resource requiring continuous management scrutiny and control to ensure its effective application in terms of the results achieved and their cost in relation to agency mission objectives.

AID's financial management needs in regard to the Loan Program and its objectives to be accomplished through that program therefore include, in our opinion, a need to provide, as an integral part of the accounting system, for allocation of the costs of this particular resource as well as the costs of other resources. The present accounting system records AID's administrative costs, including those pertaining to the Loan Program, only according to fund source and organizational unit, and thus does not provide program costs.

UNRELIABLE FINANCIAL MANAGEMENT INFORMATION

Our examination into the records maintained in support of the Loan Program financial statements disclosed, as shown on pages 9 to 38, that the data provided were incorrect in principle and significantly inaccurate in that (1) certain loan balances, accrued interest, and interest income were overvalued and net exchange losses were understated because the loans were incorrectly classified as having maintenance-of-value provisions and (2) exchange rate losses on disputed exchange rate receipts were recognized prematurely. Also, there were a number of accounting errors and deficiencies that materially affected certain balances. The financial information provided was, to that extent, unreliable and misleading to management in respect to resources available and operating results.

As indicated above, several of the instances of inaccurate and incomplete data represent Agency system deviations from accounting principles and standards prescribed by the Comptroller General and designed to ensure that management is provided with complete, accurate, and current significant financial management data.

REQUIRED DATA NOT GENERATED BY ACCOUNTING SYSTEM

The Loan Program accounting system did not include provision for maintenance of continuous financial records on a consolidated basis of the current status and operating results of the overall Loan Program or on the status of "funds available from other A.I.D. appropriations," an important Loan Program resource. Instead, for financial statement purposes at year-end and at interim times, the several groups of accounts maintained for the various types of loans administered by AID are consolidated for overall financial reports and the balance of funds available from multipurpose appropriations is ascertained by analysis of data derived from allotment records and supporting documents pertaining to the loans which are funded from those appropriations.

Omission of provision for continuous accounting control of the overall loan activities and resources denies Agency management information on a current, reliable basis with respect to the internal management (in the field and in Washington) and the Agency's responsibilities to the Congress and to the central budget, accounting, and reporting agencies of the Government.

AGENCY FINANCIAL MANAGEMENT NEEDS IN RESPECT TO PROGRAM OBJECTIVES

During our review of AID's accounting in support of its financial statements, we noted that the Loan Program general and subsidiary ledgers were maintained in terms of the type of loan involved and that loan financial management data in regard to Agency and country program objectives were available only by special analysis and recasting of coded information on basic documents. The Loan Program accounting system thus ignores the primary country program objectives of the Agency although loans are only a means of financing such objectives.

AID utilizes coded basic documentary data to prepare analytical-type reports relating to its country and program objectives. However, the weaknesses in the present accounting system, as described on the preceding pages, necessarily have an adverse affect on the completeness, accuracy, and reliability of data prepared in this manner.

WEAK INTERNAL CONTROLS

Internal check procedures in the International Loan Branch, including supervisory review, reconciliations of data generated internally, and reconciliations with data generated externally--particularly by the Treasury Department--are noticeably lacking in the degree necessary to minimize the number of errors that are entered into the accounting records and flow through to management in financial reports. We observed that supervisory personnel are occupied for a disproportionate amount of time in actually preparing the more complex detailed accounting analyses at the expense of time available for reviewing the work of subordinate personnel.

The accounting procedures that are in effect have not been formalized and issued in manual form. Supervisory personnel must depend upon oral instructions to direct the work of the Branch. We noted instances where major errors in the accounting records were apparently caused by misunderstandings on the part of subordinate personnel as to exactly what information was needed, where it should be obtained, and how it should be recorded in the accounting records. These errors, which required considerable effort to isolate and correct, might not have occurred had there been written accounting procedures and instructions available to guide these employees.

In addition to the shortcomings in accounting procedures, we believe that the errors disclosed in our audit were at least partially attributable to the personnel of the International Loan Branch not exercising sufficient care in preparing and recording financial data in the accounting records. Contributing to this situation is the fact that the internal check procedures are such that errors are not disclosed in many cases until a considerable length of time has elapsed. This time lag makes it difficult not only to isolate and correct errors but also to pinpoint individual responsibility for the errors.

During our audit for the 3 fiscal years, accounting errors were brought to the attention of appropriate AID personnel and, in most cases, the items were corrected. For errors affecting the fiscal year 1964 financial statements, however, the corrections in most cases were not made prior to the closing of the fiscal year 1964 records and issuance of the financial statements. Although our audit was directed specifically at the annual financial statements, the errors and the unsound accounting practices disclosed during our audit also affected data used in other AID reports.

NEED FOR INTERNAL AUDIT

No internal audits have been made of the accounting aspects of the Loan Program in AID Washington headquarters since AID was established in 1961, although periodic audits by an internal audit staff are an important means of achieving and maintaining a sound accounting system. We were informed by the Chief of the Internal Audit Branch that no work had been done in this area because of the heavy demand for internal audit work elsewhere, particularly at the AID missions in foreign countries.

We believe that, on the basis of the information herein disclosed, there is a critical need for an effective internal audit program and that the Agency's stated plan to have its internal audit staff periodically schedule audits of the accounting for the Loan Program, to be meaningful, requires early specific action to (1) develop a sound audit program providing for inquiry into all significant financial management aspects of the Loan Program including those commented on herein and (2) systematic application of qualified audit manpower to such audits.

MECHANIZATION

AID's intention to mechanize the Loan Program accounting system through use of electronic data processing, if properly planned and implemented in conjunction with other financial management system needs, could contribute to a more efficient and effective system. When converting to a mechanized system, however, we believe that it is of the utmost importance to (1) provide in advance for a complete systems analysis including a provision for controlling the data, reports, and records produced by the system, (2) develop a cohesive overall plan to serve needs at the various levels, and (3) keep to a minimum the period of time necessary for operating a parallel or dual system.

CONCLUSIONS

The above-described specific accounting and reporting system and internal audit weaknesses together with the lack of accounting for utilization of loan resources in terms of Agency primary purposes, in our opinion, significantly limit AID in the knowledge needed for discharging its financial management responsibilities in terms of planning, programming, budgeting, accounting, and reporting for internal management (field and Washington), and to the Congress and to the Bureau of the Budget and the Treasury Department as the central budgeting and accounting and reporting agencies of the Government.

Although there is no legislative requirement that the Loan Program be operated on a profit or break-even basis, we believe that the cost of the program should be known. We believe also that the facts outlined show that AID, in order to fully discharge its financial management responsibilities in accordance with the principles and standards prescribed by the Comptroller General, should (1) disclose in its Loan Program financial statements all significant information with respect to expenditures of all of its resources including those for administrative expenses and (2) provide such information on a continuous basis as an integral part of the accounting system needed for use at all appropriate management levels.

In view of the Agency's internal and external financial management needs with respect to the Loan Program and the emphasis currently being given the planning, programming, and budgeting aspects of Agency operations as a result of the President's recent directive, we believe that it is vital that the Agency, whether with its own forces or through a private contractor, include as an important element of its review of the Loan Program accounting system a thorough-going analysis of Agency financial management needs in terms not only of the Loan Program as a means of financing these objectives but also of the need to account for the application of Loan Program resources to the more significant program objectives themselves.

We recognize that loan accounting in regard to program objectives is dependent upon the Agency's determining its primary program purposes or "program packages" and the important elements thereof and that, to a large degree, factors not susceptible to development through accounting systems will be involved in the planning, programming, and budgeting processes. Nevertheless, in our opinion, the business-type characteristics of the Loan Program as a means of financing program plans and objectives lend themselves to the development of financial management information for use by management as an experience factor in conjunction with other considerations in determining program plans and budgets, as a means of providing bench-marks for the measurement of accomplishment of program objectives and as additional guidance in reevaluating original determinations for the purpose of making adjustments and considering new or revised alternatives.

In accordance with the Comptroller General's responsibilities under the Budget and Accounting Procedures Act of 1950 and his policy of assisting and cooperating with agencies in pursuance of the Joint Financial Management Improvement Program, we have developed working arrangements with the AID Controller for appropriate consultation and participation by our representatives with the Agency financial management personnel and through them with such external professional assistance as may be retained, in order to ensure, to the maximum extent practicable, that the new system will provide for all financial management needs as described herein.

SCOPE OF AUDIT

Our audit of the financial statements (schedules 1 through 4) of the AID Loan Program for fiscal years 1962, 1963, and 1964 was made in accordance with generally accepted auditing standards and included such tests of the accounting records and applications of such other auditing procedures as we considered necessary in the circumstances.

Prior to the establishment of AID in November 1961, the accounting for loans now administered by AID was performed by the corporate Development Loan Fund and the Export-Import Bank of Washington, which acted as principal for certain loans and as agent for other loans administered by International Cooperation Administration (ICA). In accordance with the Government Corporation Control Act (31 U.S.C. 841), the activities of these agencies had been audited annually by the General Accounting Office and reports had been issued to the Congress thereon. When these loans were transferred to AID, some difficulty was experienced in setting up the various accounts on certain types of loans. However, except as our comments in this report apply to the balances transferred to AID, we believe that these beginning balances were substantially correct.

As part of our audit we verified the correctness of outstanding loan balances on about 40 percent of the total number of loans, representing about 57 percent of the dollar value of the loans outstanding at June 30, 1964, by securing confirmations from borrowers and by reconciling differences and otherwise assuring ourselves that the Agency's records were correct.

OPINION ON FINANCIAL STATEMENTS

The accompanying financial statements (schedules 1 through 4) are the same as those prepared by AID and submitted to us. The scope of our audit is presented on page 51.

These financial statements do not, in our opinion, present fairly the financial condition of the AID Loan Program at June 30, 1964, or the results of operations of the program for the fiscal years 1962, 1963, and 1964 for the following reasons.

Our audit disclosed a number of instances where material overstatements and understatements of certain financial statement balances resulted from AID's following accounting practices which we believe are not sound. (See pp. 20 through 26.) In addition, our audit disclosed inadequacies of internal check procedures, the lack of written formalized accounting procedures and instructions, and a number of material errors and certain other deficiencies in the accounting records. (See pp. 27 through 37.)

AID has not determined the administrative expenses applicable to the Loan Program. This practice has resulted in material overstatements of the net income shown on the Statements of Income and Expense for fiscal years 1962, 1963, and 1964. It has also resulted in a material overstatement of accumulated net income shown in the June 30, 1964, Statement of Financial Condition. (See pp. 15 through 19.)

The program has certain unique aspects, as described below, which do not lend themselves to conventional evaluation processes and which significantly affect the financial position of the program. The Loan Program assets are shown in the June 30, 1964, Statement of Financial Condition at their full face value at that date; no allowance has been made for future losses which may be sustained on loans and interest receivable. Because of the many indeterminable factors which may affect these loans and the related interest receivable, we do not believe that future losses can be estimated with the degree of reliability necessary to arrive at a meaningful allowance for such losses. Also, a substantial part of the assets consists of foreign currency cash balances and loans and interest receivable which are repayable in foreign currency without maintenance-of-value provisions and which are not freely convertible to United States dollars. (See pp. 9 through 15.)

We do not believe that the Agency will be able to fully discharge its responsibility for accounting and reporting under the law (Foreign Assistance Act of 1961 and the Budget and Accounting Procedures Act of 1950) unless it makes the improvements in its accounting, internal controls, and reporting that we have recommended. While we believe that the circumstances described above will preclude an unqualified opinion on the financial statements, we believe also that, when such improvements have been accomplished, we will be able to render an opinion properly qualified to reflect unique aspects of the program.

FINANCIAL STATEMENTS

A G E N C Y F O R I N T E R N A T I O N A L D E V E L O P M E N T

LOAN PROGRAMS

STATEMENT OF FINANCIAL CONDITION

AS OF JUNE 30, 1964

ASSETS

FUND BALANCES WITH U.S. TREASURY (note 1)		$ 2,800,228,918
CASH IN TRANSIT (note 1)		3,132,759
FOREIGN CURRENCIES WITH U.S. TREASURY AND IN FOREIGN BANKS (notes 1 and 5)		760,222,804
RESTRICTED FUNDS UNDER SPECIAL LETTERS OF CREDIT		6,820,121
FUNDS AVAILABLE FROM OTHER A.I.D. APPROPRIATIONS (notes 1 and 2):		
In U.S. dollars	$ 180,622,398	
In foreign currencies	1,795,365	182,417,763
LOANS RECEIVABLE (notes 3, 4 and 5):		
Repayable in U.S. dollars	3,145,733,908	
Repayable in foreign currencies with maintenance of value	2,990,385,909	
Repayable in foreign currencies with no maintenance of value	1,279,680,896	7,415,800,713
ACCRUED INTEREST RECEIVABLE (notes 3, 4 and 5):		
Payable in U.S. dollars	15,403,140	
Payable in foreign currencies with maintenance of value	36,681,823	
Payable in foreign currencies with no maintenance of value	11,280,523	63,365,486
DEFERRED INTEREST RECEIVABLE (note 4)		45,028,734
OTHER ASSETS		46,635
Total assets		$11,277,063,933

The notes to the financial statements on pages 63 to 65 are an integral part of this statement.

The opinion of the General Accounting Office on these financial statements appears on page 52.

A G E N C Y   F O R   I N T E R N A T I O N A L   D E V E L O P M E N T

LOAN PROGRAMS

STATEMENT OF FINANCIAL CONDITION

AS OF JUNE 30, 1964 (continued)

LIABILITIES AND U.S. GOVERNMENT INVESTMENT

LIABILITIES:			
Interest payable on borrowings from U.S. Treasury		$ 9,603,322	
Accounts payable--other		1,334,886	
Unapplied credits (due to disputed foreign currency exchange rates)		8,309,597	
Deferred interest income (notes 4 and 7)		45,028,734	
Total liabilities			$ 64,276,539
U.S. GOVERNMENT INVESTMENT:			
Interest bearing capital:			
Borrowings from U.S. Treasury			735,329,390
Non-interest bearing capital (schedule 4):			
Dollar appropriations and foreign currency allocations		11,344,447,497	
Accumulated net income		169,982,724	
		11,514,430,221	
Capital transfers to U.S. Treasury:			
Principal collections	$360,554,174		
Interest collections	543,756,237		
Capital transfers to other agencies and funds	132,661,806		
		1,036,972,217	
			10,477,458,004
U.S. Government investment (net)			11,212,787,394
Total liabilities and U.S. Government investment			$11,277,063,933

The notes to the financial statements on pages 63 to 65 are an integral part of this statement.

The opinion of the General Accounting Office on these financial statements appears on page 52.

AGENCY FOR INTERNATIONAL DEVELOPMENT

LOAN PROGRAMS

STATEMENT OF INCOME AND EXPENSE AND ACCUMULATED NET INCOME

FOR THE FISCAL YEARS ENDED JUNE 30, 1964, 1963 AND 1962

	Fiscal year 1964	Fiscal year 1963	Fiscal year 1962
INCOME:			
Interest earned on loans:			
In U.S. dollars	$ 56,827,348	$ 54,709,480	$ 54,629,587
In foreign currencies	150,769,508	123,097,964	87,382,691
Interest earned on foreign currencies on deposit with foreign banks	26,894	-	-
Other income	980	-	-
Total income	207,624,730	177,807,444	142,012,278
EXPENSES:			
Fees of Inspector General	296,143	269,817	168,679
Foreign currency costs of Cooley Loans	2,667	-	198,126
Interest on borrowings from U.S. Treasury	14,172,398	15,635,851	20,631,732
Net exchange rate losses (The fiscal year 1964 losses include $14,940,999 of unrealized losses in translating foreign currency long-term loans receivable.)	63,977,381	142,316,440	53,209,321
Total expenses (notes 6 and 8)	78,448,589	158,222,108	74,207,858
Net income before extraordinary charges	129,176,141	19,585,336	67,804,420
Extraordinary charges:			
Prior year adjustments (note 7)	38,529,563	(1,003)	(157,662)
Unrealized losses on translation of foreign currency (non-maintenance of value) loans converted from maintenance of value loans	79,047,477	12,602,151	-
	117,577,040	12,601,148	(157,662)
Net income after extraordinary charges (notes 6 and 8)	$ 11,599,101	$ 6,984,188	$ 67,962,082
ACCUMULATED NET INCOME:			
Accumulated net income at beginning of year	$158,383,623	$151,399,435	$ 83,437,353
Net income for the fiscal year	11,599,101	6,984,188	67,962,082
Accumulated net income at end of year	$169,982,724	$158,383,623	$151,399,435

The notes to the financial statements on pages 63 to 65 are an integral part of this statement.

The opinion of the General Accounting Office on these financial statements appears on page 52.

AGENCY FOR INTERNATIONAL DEVELOPMENT

LOAN PROGRAMS

SOURCE AND APPLICATION OF FUNDS

FISCAL YEAR ENDED JUNE 30, 1964

FUNDS PROVIDED:		
Appropriated capital		$1,062,300,000
Foreign currency allocations from U.S. Treasury		537,808,004
Interest earned on loans:		
In U.S. dollars	$ 56,827,348	
In foreign currencies	150,769,508	207,596,856
Repayment of loans:		
In U.S. dollars	100,614,608	
In foreign currencies	68,571,669	169,186,277
Transfers from A.I.D. dollar appropriations		77,553,370
Interest earned on foreign currencies on deposit with foreign banks		26,894
Other income		980
Net change in other assets and liabilities		97,375,261
Total funds provided		$2,151,847,642
FUNDS APPLIED:		
Disbursement of loans:		
In U.S. dollars	$968,659,939	
In foreign currencies	578,756,939	$1,547,416,878
Capitalized interest during year:		
In U.S. dollars	1,589,149	
In foreign currencies	7,001,639	8,590,788
Loan repayments transferred to U.S. Treasury:		
In U.S. dollars	83,648,130	
In foreign currencies	188,993,102	272,641,232
Increase in cash		138,442,504
Repayment of borrowings from U.S. Treasury		72,064,773
Exchange rate losses		49,036,382
Prior year adjustments--net (note 7)		38,529,563
Interest paid or accrued		14,172,398
Loan repayments transferred to U.S. Department of Agriculture		10,654,314
Fees of Inspector General		296,143
Foreign currency costs of Cooley loans		2,667
Total funds applied		$2,151,847,642

The notes to the financial statements on pages 63 to 65 are an integral part of this statement.

The opinion of the General Accounting Office on these financial statements appears on page 52.

AGENCY FOR INTERNATIONAL DEVELOPMENT

LOAN PROGRAMS

STATEMENT OF CHANGES IN NON-INTEREST-BEARING CAPITAL

FOR THE FISCAL YEARS 1962, 1963, AND 1964

	Fiscal year 1962	
TRANSFERS FROM PREDECESSOR AGENCIES:		
U.S. dollars:		
Appropriated Capital (DLF)	$2,000,000,000	
Transfers from other appropriations (ICA)	1,238,539,420	
	3,238,539,420	
Foreign currencies:		
Allocations by U.S. Treasury for P.L. 480 loan programs (ICA and EXIMBANK)	2,522,662,535	
Balance at beginning of year (note a)		$5,761,201,955
INCREASES DURING YEAR:		
U.S. dollars:		
Development lending	$1,112,500,000	
Other A.I.D. appropriations	242,538,968	
		1,355,038,968
Foreign currencies:		
Transfers from U. S. Treasury:		
Foreign Currency, Surplus Agricultural Commodities, section 402 (72FT575)		
Foreign Currency, Agricultural Trade Development and Assistance Act:		
Sec. 104(d) (72FT588)		
Sec. 104(e), Cooley Loans (72FT587)	42,316,589	
Sec. 104(g) (72FT580)	444,318,925	
		486,635,514
Balance at end of year		$7,602,876,437

[a]The transfer of the loan programs to A.I.D. is considered to be retroactive as of July 1, 1961, in accordance with the provisions of the Foreign Assistance Act. The Cooley Loan Program for reporting and accounting purposes was also established on A.I.D. records as of July 1, 1961, consistent with the other assumed programs, although the transfer was effective as of January 1, 1962.

Fiscal year 1963		Fiscal year 1964	
	$7,602,876,437		$ 9,666,786,123
$1,400,000,000		$1,062,300,000	
99,187,073		77,553,370	
	1,499,187,073		1,139,853,370
6,481,265		(59,539)	
166		1,000,000	
60,278,061		36,863,988	
497,963,121		500,003,555	
	564,722,613		537,808,004
	$9,666,786,123		$11,344,447,497

AGENCY FOR INTERNATIONAL DEVELOPMENT

LOAN PROGRAMS

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 1964

1. Fund balances with U.S. Treasury and in banks, cash in transit, and amounts which are available from other A.I.D. appropriations as of June 30, 1964, are available for the following purposes:

	Fund balances with U.S. Treasury		
	Agency accounts	Allocation to other agencies	Total (schedule 1)
Undisbursed loan agreements	$1,930,592,921	$63,016,590	$1,993,609,511
Loan authorizations outstanding	798,865,000	-	798,865,000
Uncommitted funds available for lending	73,682	-	73,682
Expired Cooley Loan Funds--availability subject to Bureau of Budget approval	-	-	-
Available for transfer to U.S. Treasury	533,070	-	533,070
Available for transfer to Department of Agriculture	6,013,763	-	6,013,763
Accounts payable	1,334,886	-	1,334,886
Interest collections reserved pending appropriation	6,619,127	-	6,619,127
Restricted funds under special letters of credit	(6,820,121)	-	(6,820,121)
Total	$2,737,212,328	$63,016,590	$2,800,228,918

The amount of $563,972,491 shown in the column "Foreign currencies with U.S. Treasury and in foreign banks" reported on the line "Undisbursed loan agreements" contains in part deposits actually made in advance of the execution of a loan agreement.

Foreign currencies with U.S. Treasury and in foreign banks (schedule 1)	Funds available from other A.I.D. appropriations (schedule 1)	Cash in transit (schedule 1)	Total
$563,972,491	$182,417,763	$ 14,683	$2,740,014,448
24,953,511	-	-	823,818,511
123,262,193	-	-	123,335,875
48,022,186	-	-	48,022,186
12,423	-	3,030,712	3,576,205
-	-	-	6,013,763
-	-	-	1,334,886
-	-	87,364	6,706,491
-	-	-	(6,820,121)
$760,222,804	$182,417,763	$3,132,759	$3,746,002,244

2. "Funds Available from Other A.I.D. Appropriations" represents undisbursed loan agreements funded from other U.S. dollar and foreign currency grant funds. Funds covering foreign currency loans under Sec. 402 of the MSA Act, as amended, included undisbursed procurement authorizations under U.S. dollar grant appropriations. However, amounts not yet realized by A.I.D. under P.L. 480 sales agreements are excluded from this statement.

3. A maintenance of value loan (MOV) is stated in terms of U.S. dollars, but the borrowers have the option to repay the loan in units of foreign currency. The borrower assumes the risk of exchange fluctuations or of currency revaluation. A NON MOV (non maintenance of value) loan is stated in terms of foreign currency units, the U.S. assumes the risk of foreign exchange loss during the life of the loans. Such loans were funded principally from local currency sales proceeds of Surplus Agricultural Commodities under Title I of P.L. 480 and Section 402 of the Mutual Security Act, as amended.

4. As of June 30, 1964, there were delinquent semi-annual installments in the amounts of $4,704,788 on principal and $4,924,144 on interest, applicable to thirty-nine (39) loans with outstanding balances of $123,314,922. There was also deferments of principal and interest installments of $38,581,653 and $45,028,734, respectively, in connection with five (5) loans with outstanding balances of $286,245,744. No amount was provided as an allowance for losses on receivables because of the absence of an experience factor on which to estimate possible future losses. However, a non-interest bearing loan of $1,000,000 made to the People to People Foundation (Project HOPE) with an outstanding balance of $970,000 was converted to a grant by the action of the Administrator, and, by reason of an amendment to a loan to the Government of Libya (Loan No. 670-B-002) $1,366,300 was also converted to a grant-in-aid. These two (2) loans were not financed from development loan funds, but represented expenditures from prior years' grant appropriations.

5. Foreign currency balances of funds and loans receivable as of June 30, 1964 have been translated into U.S. dollar equivalents at rates of exchange prescribed by Treasury Circular 930, revised, with the following exceptions:

(a) Loans receivable which are repayable with maintenance of value are accounted for and reported at values established in loan agreements.

(b) Foreign currency loan transactions prior to January 1, 1962 are not reflected in this report at Treasury Circular 930 rates.

6. Basically, the costs of administering the loan programs are funded from over-all agency grant or administrative expense appropriations. The costs reported in this statement include only those funded from loan funds pursuant to specific provisions of legislation.

7. Net prior year adjustments include $38,731,017 of interest earned in prior years for which collection has been deferred to periods after the original terminal installment due date.

8. The 1963 and 1962 Statement of Income and Expense has been reclassified to a basis comparable with 1964; the reclassifications made do not effect the net income reported for the prior years.

APPENDIXES

REPORTS ISSUED

TO THE CONGRESS DURING CALENDAR YEAR 1964

ON FINANCIAL ASPECTS

OF AID LOAN PROGRAM

Report Title	Report Reference	Report Date
Undercollections of interest and principal in foreign currencies on certain loans to foreign governments	B-146928	July 17, 1964
Improper retention of dollar collections on loans made by corporate Development Loan Fund	B-133220	Sept. 3, 1964

PRINCIPAL OFFICIALS OF
THE AGENCY FOR INTERNATIONAL DEVELOPMENT
RESPONSIBLE FOR ADMINISTRATION OF THE LOAN PROGRAM
DISCUSSED IN THIS REPORT

	Appointed
ADMINISTRATOR:	
Fowler Hamilton	Sept. 1961
David E. Bell	Dec. 1962
ASSISTANT ADMINISTRATOR FOR ADMINISTRATION:	
Harrell T. Vance (acting)	May 1962
Bernard T. Brennan	Aug. 1962
Robert Ihrie (acting)	June 1963
William O. Hall	Sept. 1963
CONTROLLER:	
Edward F. Tennant	Nov. 1959
Charles F. Flinner	Sept. 1964

MEMBERS OF DEVELOPMENT LOAN COMMITTEE

DURING PERIOD COVERED IN THIS REPORT

	Appointed to Committee
ADMINISTRATOR, AID (CHAIRMAN):	
Fowler Hamilton	November 1961
David E. Bell	December 1962
ASSISTANT ADMINISTRATOR, OFFICE OF DEVELOPMENT FINANCE AND PRIVATE ENTERPRISE, AID:	
Arthur M. McGlaughlin	November 1961
Ross D. Davis	February 1962
Seymour M. Peyser	June 1962
Donald W. Hoagland	February 1965
ASSISTANT SECRETARY OF STATE FOR ECONOMIC AFFAIRS:	
Edwin M. Martin	November 1961
G. Griffith Johnson	April 1962
ASSISTANT SECRETARY OF THE TREASURY:	
John Leddy	November 1961
John C. Bullitt	December 1962
Merlyn N. Trued	October 1964
CHAIRMAN OF THE BOARD OF DIRECTORS OF THE EXPORT-IMPORT BANK OF WASHINGTON:	
Harold F. Linder	November 1961

AGENCY FOR INTERNATIONAL DEVELOPMENT

LOAN PROGRAMS

STATUS OF LOAN AGREEMENTS--JUNE 30, 1964 (note a)

Legislative authority	Signed loan agreements Number	Signed loan agreements Amount	Loan disbursements
DEVELOPMENT LOANS AUTHORIZED BY SECTION 201--FOREIGN ASSISTANCE ACT OF 1961 (p. 74):			
All repayable in dollars	117	$ 2,154,959,375	$ 983,495,403
DEVELOPMENT LOANS TO LATIN AMERICA AUTHORIZED BY SECTION 251--FOREIGN ASSISTANCE ACT OF 1961 (p. 77):			
All repayable in dollars	77	731,350,000	301,241,737
SUPPORTING ASSISTANCE LOANS AUTHORIZED BY SECTION 401--FOREIGN ASSISTANCE ACT OF 1961 (p. 78):			
Repayable in dollars	17	262,107,720	164,840,586
Repayable in foreign currency with MOV	3	50,000,000	18,346,643
LOANS AUTHORIZED BY SECTION 104(d)--PUBLIC LAW 480 (p. 80):			
All repayable in foreign currency with MOV	6	8,561,062	7,161,024
LOANS AUTHORIZED BY SECTION 104(e)--PUBLIC LAW 480 (p. 80):			
All repayable in foreign currency without MOV	236	187,575,546	140,231,888
LOANS AUTHORIZED BY SECTION 104(g)--PUBLIC LAW 480 (p. 81):			
Repayable in dollars	13	135,488,868	133,377,316
Repayable in foreign currency with MOV	58	1,257,139,439	1,135,046,293
Repayable in foreign currency without MOV	112	2,387,162,002	1,303,106,250
LOANS AUTHORIZED BY LATIN AMERICAN DEVELOPMENT ACT (p. 82):			
All repayable in dollars	8	109,490,000	91,302,433
DEVELOPMENT LOANS MADE BY CORPORATE DEVELOPMENT LOAN FUND (p. 83):			
Repayable in dollars	40	380,047,813	284,350,435
Repayable in foreign currency with MOV	160	1,493,740,292	1,197,385,709
Repayable in foreign currency without MOV	3	2,268,317	2,268,317
LOANS AUTHORIZED BY MUTUAL SECURITY ACT OF 1954 (p. 84):			
Repayable in dollars	25	247,538,290	247,390,758
Repayable in foreign currency with MOV	55	811,743,244	778,034,930
Repayable in foreign currency without MOV	4	29,618,958	29,564,137
LOANS AUTHORIZED BY LEGISLATIVE AUTHORITIES PRIOR TO THE MUTUAL SECURITY ACT OF 1954 (p. 85):			
Repayable in dollars	77	1,674,056,425	1,674,056,425
Repayable in foreign currency without MOV	6	29,315,173	29,315,173
Total	1017	$11,952,162,524	$8,520,515,457

[a]This schedule was prepared directly from records and reports of the Office of the Controller, AID. With the exception of certain reclassifications, the information presented in this schedule summarizes the detailed information on outstanding loan agreements presented in the quarterly AID report entitled "Status of Loan Agreements."

[b]Net exchange rate losses (or gains) consist of the cumulative losses and gains arising from foreign currency transactions and the revaluation of outstanding loan balances for loans which are repayable in foreign

Loan repayments	Interest collections	Net exchange rate loss, (gain) (note b)	Outstanding balance: Total	Dollars	Repayable in: Foreign currency with MOV	Foreign currency without MOV
$ -	$ 5,475,483	$ -	$ 983,495,403	$ 983,495,403	$ -	$ -
-	3,249,754	-	301,406,286[c]	301,406,286	-	-
451,613	5,466,547	-	164,388,973	164,388,973	-	-
-	288,128	-	18,346,643	-	18,346,643	-
447,299	752,414	-	6,713,725	-	6,713,725	-
26,386,306	16,902,103	9,822,993	104,039,524[c]	-	-	104,039,524
96,515,862	5,559,419	-	36,861,454	36,861,454	-	-
5,872,206	115,070,137	-	1,129,174,087	-	1,129,174,087	-
217,231	56,783,160	174,678,729	1,128,210,290	-	-	1,128,210,290
16,200	821,712	-	91,286,233	91,286,233	-	-
30,086,488	25,139,340	-	255,688,549[c]	255,688,549	-	-
131,909,966	96,693,625	-	1,072,450,309[c]	-	1,072,450,309	-
6,519	149,263	−50,730	2,318,071[c]	-	-	2,318,071
33,855,870	36,010,768	-	213,534,888	213,534,888	-	-
14,333,785	108,007,688	-	763,701,145	-	763,701,145	-
-	1,750,488	−28,254	29,592,391	-	-	29,592,391
574,984,303	408,414,993	-	1,099,072,122	1,099,072,122	-	-
11,380,946	9,507,067	2,413,607	15,520,620	-	-	15,520,620
$926,464,594	$896,042,089	$186,836,345	$7,415,800,713[c]	$3,145,733,908	$2,990,385,909	$1,279,680,896

currency and do not contain maintenance-of-value provisions. These amounts do not include exchange rate losses and gains which have been incurred on foreign currency cash balances.

[c]Outstanding balances include amounts due from borrowers for capitalized interest. For this reason, the amounts shown as outstanding balances cannot be reconciled with the amounts shown for loan disbursements, loan repayments, and net exchange rate losses and gains.

DESCRIPTION OF LEGISLATIVE AUTHORITIES UNDER WHICH LOANS ADMINISTERED BY AID WERE ORIGINALLY MADE

In addition to the responsibility for administering loans made by AID since the Agency was established in November 1961, AID is responsible for administering loans made pursuant to several legislative authorities in existence at various times since the foreign assistance program was initiated following World War II. A description of the various legislative authorities under which loans administered by AID were originally made is presented below. Total loans outstanding, in millions, at June 30, 1964, is shown parenthetically in the captions for the specific legislative authorities.

LOANS AUTHORIZED BY THE FOREIGN ASSISTANCE ACT OF 1961

The Foreign Assistance Act of 1961 (22 U.S.C. 2151) replaced the Mutual Security Act of 1954 (22 U.S.C. 1750) as the basic legislation governing the provisions of economic and military assistance to foreign countries. This act provided that, wherever possible, assistance be extended in the form of loans and particularly emphasized development loans repayable in dollars. Loans have been made by AID under three sections of the act: section 201--development loans, section 251--development loans to Latin America (Alliance for Progress), and section 401--supporting assistance loans. Each of these three basic lending authorities under the Foreign Assistance Act of 1961 is discussed below.

Development loans authorized by section 201 ($983 million)

Section 201 of the Foreign Assistance Act of 1961 established a fund, referred to as the Development Loan Fund (DLF), to make loans to promote the economic development of less developed friendly countries and areas with emphasis upon assisting long-range plans and programs designed to develop economic resources and increase productive capacities. This loan program supplanted the one previously administered by the corporate Development Loan Fund, but the name was retained since the Congress believed that it would provide continuity of the development lending program and avoid possible confusion, particularly in foreign countries. Important changes in the development lending function under the new act included (1) a 5-year authorization for annual appropriations, (2) an authorization to enter into agreements committing funds authorized to be appropriated, subject to only the annual appropriation of such funds, and (3) a requirement for dollar repayment of loans made from the fund.

The act requires that loans under this program be made only upon a finding of reasonable prospects of repayment. In making these loans, AID must take into account the following six specific considerations.

1. Whether financing could be obtained in whole, or in part, from other free world sources on reasonable terms including private sources within the United States.

2. The economic and technical soundness of the activity to be financed, including the capacity of the recipient country to repay the loan at a reasonable rate of interest.

3. Whether the activity gives reasonable promise of contributing to the development of economic resources or to the increase of productive capacities in furtherance of the purposes of this program.

4. The consistency of the activity with, and its relationship to, other development activities being undertaken or planned and its contribution to realizable long-range objectives.

5. The extent to which the recipient country is showing a responsiveness to the vital economic, political, and social concern of its people and demonstrating a clear determination to take effective self-help measures.

6. The possible effects upon the United States economy, with special reference to areas of substantial labor surplus, of the loan involved.

Initially, the terms of most of the loan agreements made under authority of section 201 of the act provided for a 40-year maturity, including a 10-year grace period before the first repayment of principal became due, and an annual three fourths of 1 percent interest rate on the outstanding balance. However, the Foreign Assistance Act of 1963 (77 Stat. 379) amended the Foreign Assistance Act of 1961 by specifically requiring that funds must be loaned at a rate of interest not less than 2 percent per annum beginning not later than 10 years after the date on which the funds become initially available under the loan. During the initial 10-year period, the rate of interest may be as low as three fourths of 1 percent per annum. The Foreign Assistance Act of 1964 (78 Stat. 1009) raised the minimum rate of interest for the first 10-year period to 1 percent and the rate for the balance of the loan period to 2-1/2 percent. At June 30, 1964, interest rates on outstanding loans made from the new DLF under section 201 of the act ranged from three fourths of 1 percent to 5-3/4 percent and the repayment periods ranged from 10 to 40 years. Most of the longer term loans have a 10-year grace period before the first principal repayment becomes due.

Since its inception in fiscal year 1962, the new DLF has received annual appropriations through June 30, 1964, totaling $2,774.8 million. In addition, pursuant to an administrative policy determination in fiscal year 1964, AID transferred $74.6 million of deobligated and decommitted funds from the corporate DLF to the new DLF. Prior to the enactment of the Foreign Aid and Related Agencies Appropriation Act of 1964 (77 Stat. 857), the fund was in the nature of a revolving fund wherein repayments of principal and collections of interest were available for relending. The 1964 appropriation act, however, provided that loan repayments and interest collections were not available for relending thereafter unless specified in the appropriation acts.

<u>Development loans to Latin America authorized by section 251 ($301 million)</u>

Section 251 of the Foreign Assistance Act of 1961, as amended, provides separate authority for development assistance to countries and areas in Latin America under the title of "Alliance for Progress." This authority was added to the act by the Foreign Assistance Act of 1962 (76 Stat. 255). Assistance furnished under section 251 of the act is to be directed toward the development of human, as well as economic, resources. In making loans under this section of the act, AID must take into account similar considerations applicable to new DLF loans and, as is the case for new DLF loans, Alliance for Progress development loans made through 1964 must be repaid in dollars.[1] Interest rates on outstanding loans range from three fourths of 1 percent to 5-3/4 percent, and repayment periods range from 8 to 40 years. Most of the longer term loans include a 10-year grace period before the first repayment of

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[1]Section 252 of the act provides that, except for $100 million in each of the fiscal years 1963 and 1964 and $85 million for fiscal year 1965, Alliance for Progress loans must be repaid in dollars.

principal becomes due. The amendments to the Foreign Assistance Act of 1961 relating to minimum interest rates on new DLF loans also apply to Alliance for Progress development loans.

Annual appropriations totaling $800 million through fiscal year 1964 have been made for Alliance for Progress development loans. In addition, AID transferred to the Alliance for Progress development loan appropriation $51.3 million from the new DLF for the undisbursed portion of new DLF loans to Latin America, $1.2 million of receipts of interest on new DLF loans to Latin America, and $2.5 million from the fiscal year 1964 development grant appropriation for Latin America. Prior to the enactment of the Foreign Aid and Related Agencies Appropriation Act of 1964, all principal repayments and interest collections on loans made from Alliance for Progress development loan appropriations were available to AID for relending. The 1964 appropriation act, however, provided that loan repayments and interest collections were not available for relending thereafter unless specified in the appropriation acts.

<u>Supporting assistance loans
authorized by section 401 ($183 million)</u>

Section 401 of the Foreign Assistance Act of 1961 provides authority to furnish assistance to friendly countries, organizations, and bodies in order to support or promote economic or political stability. This authority is used to extend assistance by grants and loans in those situations where basic economic conditions make the strict criteria of development assistance inapplicable and is normally used to meet the economic requirements of countries facing major political or military threats to their stability. Loans made pursuant to this authority are repayable in dollars and local currency with maintenance-of-value provisions. The loans are repayable over periods of from 3 to 40 years, and the interest rates range from three fourths of 1 percent to 7 percent.

LOANS AUTHORIZED BY THE AGRICULTURAL TRADE DEVELOPMENT AND ASSISTANCE ACT OF 1954

The Agricultural and Trade Development and Assistance Act of 1954 (7 U.S.C. 1691), commonly referred to as Public Law 480, is the implementing legislation for the Food for Peace Program. Title I of the act authorizes the President to negotiate and carry out agreements with friendly nations, or organizations of friendly nations, to provide for the sale of surplus agricultural commodities for foreign currencies and to use, or enter into agreement with friendly nations to use, the foreign currencies, including principal and interest from loan repayments that accrue under title I.

The purposes for which Public Law 480 currencies may be used are stated in section 104 of the act, and, within the authority of the law, the purposes are generally agreed upon in each sales agreement. The uses of these currencies may be divided into three major categories (1) recipient country uses, chiefly for economic development through loans and grants and for military procurement through grants, (2) loans to private business firms, and (3) United States uses, such as administrative operations, agricultural marketing programs, international educational exchange, and military housing. Foreign currency loans have been made pursuant to sections 104(d)--purchase of goods or services for other friendly countries, 104(e)--loans to private enterprise, and 104(g)--loans to foreign countries. Prior to the establishment of AID in November 1961, Public Law 480 loans made under authority of sections 104(d) and 104(g) were administered by the International Cooperation Administration (ICA)--the predecessor agency of AID--

and loans made under authority of section 104(e) were administered by the Export-Import Bank of Washington. Loans made pursuant to these three sections of Public Law 480 are described in the following sections.

Loans authorized by section 104(d)
($7 million)

Section 104(d) provides for the use of United States-owned foreign currencies of one friendly country to finance the purchase of goods or services for other friendly countries. The loans are repayable in the currency of the borrowing country with maintenance-of-value provisions or, for some loans, in dollars at the option of the borrower. The loans are repayable over periods of from 10 to 40 years, and the rates of interest range from three fourths of 1 percent to 4 percent with interest on some loans 1 percent higher if payment is in local currency rather than in dollars

Loans authorized by section 104(e)
($104 million)

Section 104(e) of the act provides that foreign currencies received by the United States in payment for surplus agricultural commodities shall be available to the maximum usable extent for loans to borrowers to develop business and expand trade in foreign countries. These foreign currency loans, referred to as Cooley amendment loans, are available (1) to United States firms and branches, subsidiaries, and affiliates for business development and trade expansion in foreign countries and (2) to domestic or foreign firms for the establishment of facilities for aiding in the utilization, distribution, or otherwise increasing the consumption of, and markets for, United States agricultural products.

Cooley loans are repayable in local currency without maintenance-of-value provisions over periods of from 1 to 20 years with most loans repayable over a period of less than 10 years. With the exception of one loan which by amendment was converted to a non-interest-bearing loan, interest rates range from 4 percent to 12 percent.

Loans authorized by section 104(g)
($2,294 million)

Loans to promote multilateral trade and economic development are made to foreign governments from section 104(g) foreign currency allocations of Public Law 480 sales proceeds. These loans are made to finance (1) local currency costs of projects whose foreign exchange costs are being financed by United States or international lending agencies, (2) local costs of procuring various commodities and services, (3) public expenditures for roads, port and storage facilities, and other improvements, and (4) general projects contributing to the economic development of the foreign country.

Interest rates on 104(g) loans range from three fourths of 1 percent to 5-3/4 percent with interest on some loans 1 percent higher if payment is in local currency rather than in dollars. Loans are repayable over periods of from 8 to 40 years. With the exception of several loans repayable in dollars, section 104(g) loans are repayable in local currency with the option by the borrower to repay in dollars. Except for six loans which were renegotiated to delete the maintenance-of-value provisions, loans repayable in local currency, which were authorized from the proceeds of sales agreements signed prior to fiscal year 1959, include maintenance-of-value provisions. Loans repayable in local currency, which were funded from the proceeds of sales agreements executed in fiscal year 1959 and thereafter, do not include maintenance-of-value provisions.

LOANS AUTHORIZED BY THE LATIN AMERICAN DEVELOPMENT ACT ($91 MILLION)

Pursuant to the Latin American Development Act (22 U.S.C. 1942), approved September 8, 1960, AID made loans to Chile and several other Latin American countries. These loans were made to finance earthquake reconstruction and rehabilitation projects in Chile and for schools, water systems, housing, and administrative and fiscal reform in Latin American countries. Funds for these loans were provided by Public Law 41, Eighty-seventh Congress, and Public Law 258, Eighty-eighth Congress, which appropriated a total of $735 million of which $635 million was for Latin American development and $100 million specifically for Chilean reconstruction. The appropriation acts provided that the funds made available could be used on such terms and conditions that the President may specify.

Of the $635 million appropriated for Latin American development, $100 million was allocated to ICA (predecessor to AID) for loans and grants, and, at June 30, 1964, loan agreements totaling $9.5 million had been signed and $0.9 million had been disbursed. The remaining $535 million was allocated to the Social Progress Trust Fund ($525 million) and the Organization of American States ($10 million). The Social Progress Trust Fund, which is administered by the Inter-American Development Bank under a trust agreement with the United States, makes loans to Latin American countries. These loans are not included in this report.[1]

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[1]AID's records show that, as of June 30, 1964, a total of $124,000,000 had been paid into the Fund and that the equity of the United States in the Fund was $118,400,194.

Of the $100 million appropriated specifically for Chilean reconstruction, a loan agreement for the full $100 million was signed with Chile on August 3, 1961, and, at June 30, 1964, $90.4 million had been disbursed.

The loans administered by AID are repayable in dollars over periods of from 20 to 40 years and generally carry an interest rate of three fourths of 1 percent annually on the outstanding balance. The $100 million loan to Chile provides for a 10-year grace period before the first repayment becomes due.

LOANS MADE BY THE CORPORATE DEVELOPMENT LOAN FUND
($1,330 MILLION)

The Development Loan Fund (DLF) was established by the Mutual Security Act of 1957 (71 Stat. 357) to provide financing for economically, technically, and financially sound projects and programs in less developed nations. The Mutual Security Act of 1958 (72 Stat. 261) established the Fund as a wholly owned Government corporation. Pursuant to the provisions of the Foreign Assistance Act of 1961, the corporate DLF was abolished as a corporate entity on November 3, 1961, and its assets, liabilities, property, and records were transferred to AID. Section 201 of the act required the President to establish a fund to be known as the Development Fund which is similar in many respects to the former corporate entity.

The corporate DLF received annual appropriations totaling $2 billion through fiscal year 1961 under the annual Mutual Security appropriation acts. In addition, the legislation governing the corporate DLF provided that repayments of principal and collections of interest could be utilized for making new loans. Subsequent to the abolishment of the corporate entity on November 3, 1961, principal repayments and interest collections on corporate

DLF loans have been transferred to the Treasury as miscellaneous receipts. With the exception of $40 million, deobligated and decommitted funds have been transferred to the successor DLF for lending on a dollar-repayment basis. The $40 million was originally committed as a corporate DLF loan repayable in local currency and was recommitted on the same basis several years later.

With three exceptions where loans are repayable in local currency without maintenance-of-value provisions, corporate DLF loans are repayable in dollars and/or local currency with maintenance-of-value provisions. Interest rates range from 3-1/2 percent to 5-3/4 percent except for one loan made in foreign currency which bears interest at 8 percent. The loans are repayable over periods of from 3 to 35 years.

LOANS AUTHORIZED BY THE MUTUAL SECURITY ACT OF 1954 ($1,007 MILLION)

Prior to the enactment of the Foreign Assistance Act of 1961, the organic act relating to foreign assistance was the Mutual Security Act of 1954 (22 U.S.C. 1750). The principle purpose of this legislation was to authorize measures in common defense, including the furnishing of military assistance to friendly nations and international organizations in order to promote the foreign policy, security, and general welfare of the United States and to facilitate the effective participation of such nations in arrangements for individual and collective self-defense. Loans made pursuant to this act were made primarily to foreign governments and were in the form of lines of credits to be used to procure commodities and services to be agreed upon between the two respective governments. Loans were funded from dollar appropriations, foreign currencies generated from the export and sale of United States surplus agricultural commodities and products, or a combination of both.

Of the loans made pursuant to the Mutual Security Act of 1954, 55 have optional repayment provisions whereby the borrower may repay the loan in dollars or local currency with maintenance-of-value provisions, 25 are repayable only in United States dollars, and 4 are repayable in local currency without maintenance-of-value provisions. Interest rates on these loans range from one half of 1 percent to 5-3/4 percent with the rate generally 1 percent higher on those loans with optional repayment provisions if the borrower elects to repay the loan in local currency rather than United States dollars. The loans are repayable over periods of from 5 to 40 years.

LOANS AUTHORIZED BY LEGISLATIVE AUTHORITIES PRIOR TO THE MUTUAL SECURITY ACT OF 1954 ($1,115 MILLION)

Prior to the Mutual Security Act of 1954, foreign assistance loans now administered by AID were made under the following legislative authorities: the Economic Cooperation Act of 1948 (Marshall Plan loans), the Mutual Defense Assistance Act of 1949, the General Appropriation Act of 1951, the India Emergency Food Aid Act of 1951, and the Mutual Security Acts of 1951 and 1953. These loans were made for various purposes and were funded from dollar appropriations and borrowings from the Treasury.

Loans made pursuant to these several authorities are repayable over periods of from 9 to 45 years, and the interest rates range from 2-1/2 to 6-1/2 percent. Of the loans outstanding at June 30, 1964, 77 are repayable in dollars and 6 are repayable in local currency without maintenance-of-value provisions.

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington 25, D C

August 18, 1965

Mr. Edward T. Johnson
Associate Director
International Operations Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Johnson:

We appreciate the opportunity to comment on the General Accounting Office draft report "Audit of Agency for International Development Loan Program for Fiscal Years 1962, 1963, and 1964."

During the review of our operations, your representatives made several helpful recommendations for correction or improvement. We recognize the validity of these points and have taken, or are in the process of taking, corrective actions. We are particularly pleased to have your report contain the finding that the General Accounting Office found no inaccuracies in the amounts due to the U. S. government as a result of an intensive review of the large number of individual loans which the auditors verified during the course of the audit.

On the other hand, we disagree with a number of the underlying premises and generalized statements in the report. First, although the General Accounting Office is required by Section 635(g) of the Foreign Assistance Act of 1961 to audit our loan programs in accordance with the Government Corporation Control Act, it is clearly evident it was not Congressional intent that the loan programs of A.I.D. should be operated as a self-sustaining government corporation. Nor was it intended that these loan programs be operated on a profit or a "break-even basis." Loans made by A.I.D. and its predecessor agencies generally have been made under the "lender of last resort" concept. Loans are authorized on concessional terms for economic purposes in developing countries in support of the foreign policy objectives of the United States. It follows, therefore, that our main purpose in maintaining the loan accounting system has been that of (a) insuring proper stewardship of the U. S. resources made available for authorized loan programs, and (b) facilitating effective execution and servicing of loan agreements. The draft report in its present

Mr. Victor L. Lowe

form conveys the impression that loan accounting is primarily for the purpose of preparing yearly financial reports which will permit certification and use as a corporate or "banker's type" statement. We believe you will agree with us that A.I.D. should not maintain accounts primarily for the purpose of reflecting the financial condition of an arbitrarily-established entity, but to serve management's needs. It is important that the report recognize these concepts so that the Congress and other readers of the report will not be misled.

The Agency is presently compiling administrative costs on a dual basis; i.e., organizationally and by funding source. The compilation of A.I.D.'s administrative costs on still another basis as recommended in the report is, of course, possible, but raises a question as to the benefits to be gained in comparison to the additional costs of compiling these same data on a different basis. We believe the report should set forth this consideration in addition to our view that no significant management purpose would be served by attributing administrative expenses in the manner recommended.

We are concerned with the repetitive instances in which generalizations are contained in the report which tend to distort the condition of the accounts and the reliability of A.I.D. fiscal reports pertaining to the loan programs. A clear distinction has not been made between large monetary variations which are the result of differences of accounting judgment and the somewhat smaller amounts which the report alleges to be caused by errors. The emphasis placed in the report on (a) the overstatement of assets because of treating certain loans on a "maintenance of value" basis, (b) premature recognition of exchange rate losses on receipts in dispute, and (c) errors in interest accruals, is out of focus when coupled with the report's significant conclusion that: "The realizable value of loan program assets other than dollar cash balances is undeterminable."

The attached comments deal more specifically with other items as well as the above basic points, and are intended to supplement and clarify the material in the draft report in order that your office may consider this additional information in the preparation of your final report.

Sincerely yours,

William O. Hall

William O. Hall
Assistant Administrator for Administration

Attachment

AGENCY FOR INTERNATIONAL DEVELOPMENT
COMMENTS ON
PARTICULAR MATTERS PRESENTED IN
THE GENERAL ACCOUNTING OFFICE (GAO) DRAFT REPORT
ON THE
LOAN PROGRAM FOR FISCAL YEARS 1962, 1963, and 1964

Repetitive Discussion of Subjects Under Different Headings

Certain items covered by the report are discussed two or more times under different subject headings. This practice tends to confuse and mislead the reader. The example cited in the following paragraph is illustrative of this practice.

The subject matter on page 24 under the caption "Disputed exchange rates" is again discussed in a slightly different manner and, as a result, appears to be a different or additional finding on page 30A under the heading "Premature recognition of $4.2 million exchange losses on foreign currency receipts in dispute." Actually the procedures generally followed are those prescribed by Treasury Department Circular No. 930, as modified by a special waiver, dated December 7, 1962, granted A.I.D. by the Fiscal Assistant Secretary of the Treasury.

It is suggested that the report consolidate its presentations relative to the same subject matter, or that separate discussions on the same subject be clearly identified as such. It is further suggested that differences of opinion on the proper principles for evaluating loans payable in foreign currency be identified as differences of opinion in order to preclude confusion between errors and differences of opinion on accounting principles. It is also suggested that the report contain the following: (a) Section 613 of the Foreign Assistance Act of 1961, as amended, vested exclusive authority in the Secretary of the Treasury for the establishments of regulations on evaluation, accounting and reporting of foreign currencies, and (b) A.I.D. financial statements are in accord with Treasury's regulations.

Realizable Value of Loan Program Assets Undeterminable (Page 46)

A.I.D. believes that the report presents fairly the various reasons why A.I.D. and GAO find it not feasible to establish valuation reserves for possible uncollectible items and the effect of possible currency depreciation in various countries. On the other hand, your comments on page 46, in our opinion, leave the wrong impression. A.I.D. believes GAO as well as A.I.D. can present a financial statement in which it can express an opinion of the financial condition of the loan program, with certain qualifications which neither GAO or A.I.D. can predict with any degree of accuracy. The reader would then use his own judgment of the asset value. The statement in the report on page 46 as it now reads implies criticism of A.I.D. without adequately explaining that the unpredictiveness of the factors involved cause the problem discussed.

Elimination of Maintenance-of-Value (MOV) Provisions from Loan Agreements (Page 22)

There are a number of countries where the loan agreements were converted from MOV terms to non-MOV repayment provisions. The report as it reads is subject to the interpretation that the USA eliminated the MOV provision without offsetting considerations. Some of these considerations are of a classified nature. It is recommended that the report be changed to indicate that political or other considerations were taken into account in elimination of the MOV provision.

Overestimate of Assets Due to Over-Valuation of Certain Loans (Page 27)

We agree in principle with your recommendation on page 30A that loans repayable in local currency at a fixed rate of exchange should be accounted for as non-maintenance-of-value loans. Nevertheless, the administrative difficulties mentioned in your draft report still exist. Furthermore, to change these loans from dollar denominated to dinar denominated loans may require more than A.I.D.'s unilateral determination. We are investigating the most practical approach for this Agency to take in order to report the status of these loans as you recommended.

Exclusion of Administrative Expenses (Page 25)

The Agency is presently compiling its administrative costs on two different bases as follows:

1. Having established an appropriate organizational structure to administer the numerous types of functions and Missions assigned to the Agency, we are compiling the cost of each such organizational unit, thereby enabling us to control costs in line with our organizational structure.

2. Since administrative type costs are funded from more than one source, we are compiling our administrative costs by funding source, which cut across these organizational units in order to meet our budgetary and Congressional needs.

It is possible to prepare reports to show a compilation of A.I.D.'s administrative costs on several other bases. We feel, however, that usefulness to management should be demonstrated which would compare favorably with the additional expense involved.

Much of the function of administering the loan program is unidentifiably merged with the other functions of the Agency. The preliminary work leading up to the determination that a loan is to be made might result in a grant under another appropriation or a decision to give no aid. After the determination is made, much of the work is performed by generalists.

The administrative expense estimates for the Agency are developed and justified on this basis; and the portion of the expense applicable to the loan program, which could only be a nominal fraction of the amount appropriated for that program, would not be a significant consideration in the justification therefor. No benefit commensurate with the costs involved would be derived for management use by attributing administrative expenses in the manner recommended.

Conversion of Loans to Grants (Page 23)

1. Project Hope (People to People Foundation)

By letter of June 29, 1963, the Administrator, A.I.D., advised the President, People to People Foundation, that he agreed to a postponement of the amortization payment of $107,778, which was due on June 30, 1963. Subsequent to a further study of the financial circumstances of the Foundation and the objectives in the best interest of the United States, the Administrator approved the conversion of the loan to a grant. It should be noted that Project Hope was an important program under the former Mutual Security Programs and that considerably greater sums were expended as grants; also, the loan was made from MSP grant funds and could properly have been extended on grant terms in the first instance. As evidence of an objective served by the conversion, we quote below from a letter, dated May 4, 1965, addressed to the Administrator, A.I.D., by the President, People to People Foundation:

> "Following the cancellation of this debt, the attitude of our contributors markedly improved...(because) this demonstration of confidence by the Government in the success of our efforts made them feel even more confident that their contribution was being well expended. Thus, since the cancellation of the loan has been published in our audit, we can anticipate an increased contribution for this fiscal year in excess of three-quarters of a million dollars, and our projections for the next year indicate an even greater response."

2. Libya: Tripoli Power Project (ICAX 70-1)

The decision to make a grant of part of the loan was made by the Director of ICA on August 15, 1960, when he signed an amended project agreement. The decision was predicated on reasonable objections by the recipient country and thought to be consistent with foreign policy objectives of the United States at that time. The amended project agreement stated the kinds of expenditures which would be eligible for grant aid, and final audit showed the total of these expenditures to be $1,366,300.

The substance of the foregoing covering the Project Hope and Libya loans should be included in the report in order that the reader may interpret the audit findings in the light of the facts involved.

Accounting Errors and Deficiencies (Pages 32 and 34)

1. Errors in Derivation of "Funds Available from Other A.I.D. Appropriations"

The audit findings report a discrepancy between the amounts reflected in certain allotment accounts and the undisbursed balances of Mutual Security lines of credit established prior to A.I.D.

The account "Funds Due From Other (Grant) A.I.D. Appropriations" is an account which is offset, in effect, by the contingent commitment to disburse against line-of-credit agreements. There is no obligation to finance a line-of-credit agreement excepting to the extent of unliquidated obligations, such as PA's, PIO's, Project Agreements, etc. There are ample funds in the amount on hand and reserved equal to the unliquidated obligations of the type described above, and allocated to MSP line of credit agreements.

When the Mutual Security Program accounts were closed as of June 30, 1961, and the then existing allotment accounts were recorded in accordance with program purpose but without regard to the original funding appropriations or allotment patterns, the trail between elements of allotments and related undisbursed MSP line-of-credit agreements had to be supplanted by analytical methods.

It is suggested that the report should include the foregoing information and should note that the problem is being resolved as the undisbursed MSP lines of credit are liquidated. The March 31, 1965, Status of Loans Report showed an undisbursed balance of approximately $27 million compared to total line-of-credit agreements prior to A.I.D. totaling over $2.7 billions.

2. Interest Income of $5.6 Million Erroneously Eliminated from Accounting Records (Page 34)

This finding is related to the same transaction discussed under the heading of "Premature Recognition of $4.2 Million in Exchange Rate Losses on Foreign Currency Receipts in Dispute." We do not believe the principle of adequate disclosure is served by including as interest income in the financial statements an amount of accrued interest due which is disputed by the borrower. A.I.D. has no unilateral right under the terms of MOV loan agreements to determine the effective exchange rate on any transaction. Therefore, it is our opinion, unrealized income should not be reported as income on the financial statements when its realization is in dispute but, full disclosure of the nature of the transaction should be made in explanatory notes appended to the statements. Inasmuch as the borrower in good faith has made payments which discharge the obligation under the borrower's interpretation of the loan agreement, consistent accounting treatment demands the entire transaction be held in suspense until resolved.

3. Additional Errors in Computation of Accruals (Pages 35, 37 and 38)

   a. An error in transcribing an accrual of interest for purposes of annual financial statements is acknowledged. The correction was made in the proper period and the report was corrected by the issuance of an Errata Sheet.

   b. Failure to record 1964 collections until 1965. A.I.D. normally records collections when knowledge thereof is received. Since local currency collections do not revert to A.I.D., they are credited directly to an account with a Treasury fund symbol. Where the Treasury account amount is not received by the Treasury until after the close of the fiscal year, A.I.D.'s entry is recorded in the latter period to remain in balance with the Treasury account.

   c. Failure to record $493,000 in 1962 in A.I.D. accounts even though pointed out to us by GAO. The GAO claim that the error was brought to attention of appropriate personnel is questioned. Our investigation shows that the situation was reported to a supervisor, who gave effect to the transaction in the statistical worksheets but failed to formalize the correction with an official journal voucher. The correction was made in June 1965. It is regrettable that GAO did not bring this error to the attention of the Assistant Chief of the Branch or higher level.

   d. Error of $782,000 in transfer from MOV to non-MOV accounts. The item does not violate the accuracy of the total income for the correct period. It merely shows that much more local currency interest earned on MOV loans instead of local currency interest earned on non-MOV loans. The correction was made in June 1965.

   e. A.I.D. ties its records to Treasury, and GAO states the Treasury report was in error by $181,000. Section 1311 procedures require that A.I.D. accounts be in balance with the reciprocal accounts of Treasury, not merely reconciled. Thus, A.I.D. accedes to Treasury's request for recording transactions in the same accounting period. This accommodation to Treasury does no harm to the accounts of either Agency and is considered most economical for the United States, as it relieves Treasury of the necessity to re-open its accounts and revise innumerable reports.

It is recommended that the final report show that the errors cited have been corrected, and appropriately explain the items in paragraphs b. and e. above in the light of A.I.D.'s reporting requirements under Treasury regulations.

Mechanization of Loan Accounting (Page 42)

The report suggests a "slowing down" or deferment of mechnization of the accounting for the Loan Program, however, A.I.D. does not agree. Even though you criticize our loan operation as having inadequate internal control of data being entered to the loan ledgers (or mechanized input) you indicate, after a sizeable sampling of individual loans, that none were incorrect. With minor exceptions as to interpretation, the conditions set forth in loan agreements are clear and there appears to be no reason to delay or defer the mechanization plans for individual loan accounts. Furthermore, they are bilateral agreements where any misinterpretation on the part of A.I.D. in the treatment of a clause is always subject to question by the other signatory, if it disagrees. The treatment of various transactions for yearly financial statements has little or no effect on the mechanized handling of individual loans. Moreover, the earlier A.I.D. is able to mechanize the full loan agreements, loan accounts and billing and collection operation, the easier it will be to do such things as (1) eliminate the manually posted loan ledgers; (2) perform interest calculations and render bills for principal and interest collections; (3) prepare projections of interest and principal of future years expectations; (4) calculate interest accruals as of the end of each fiscal year for financial statement purposes; (5) perform a better job of preparing monthly reports; and (6) accomplish loan accounting without increasing the accounting staff each year to handle the average annual 20 percent cumulative increase in loan activity.

In consideration of the above, it is recommended that GAO delete the reference contained on page 42 about "slowing down" mechanization and recognize that mechanization should proceed in consonance with an integrated loan accounting system.

Accounting Systems Review and Internal Audit of Loan Activities (Page 42)

In regard to the report recommendation that the "Administrator, A.I.D., direct that a comprehensive review of the Loan Program accounting system be undertaken by the Accounting Systems Staff of the Office of the Controller...," we concur that this task should be accomplished. We plan to pursue the possibility of obtaining outside assistance to perform this task, together with the preparation of a system of accounts and reports for submission to the GAO for its review and approval.

We have noted your recommendation "that periodic audits of the accounting for the Loan Program be made by the Internal Audit Branch." According to our records, the GAO audit encompassed in the referenced audit report has been in process more than two years. During this period, we saw little value for our Internal Audit Staff to also perform an audit of the same activity, particularly in view of severe pressures for other internal audits with the limited staff available. As of the close of each fiscal year, our Internal Audit Staff did make a Section 1311 review of the obligational aspects of the International Loan Branch activities. In the future, however, we plan to have the staff periodically schedule audits of loan accounting as you have recommended.

Minor Changes in Wording

There are a number of sentences included in the draft report which should be reworded to be more factual. A.I.D. representatives will be glad to discuss these with you in the interests of clarity.

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