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Memorandum Report On
USAID/Kenya's Need
For A Trust Fund

Audit Report No. 3-615-86-6
February 28, 1986

MEMORANDUM

DATE: February 28, 1986

FROM: Richard C. Thabet, RIG/A/Nairobi

SUBJECT: Memorandum Report On USAID/Kenya's Need For A Trust Fund, Audit Report No. 3-615-86-6

TO: Mr. Charles Gladson, Director, USAID/Kenya

This report presents the results of our review on the need to establish a trust fund to finance local currency costs of USAID/Kenya's Operating Expense Budget.

BACKGROUND

In 1976, the Agency (AID) established the Operating Expense Account as a distinct budget category for internal management purposes. This separate account was created to provide better financial control and to facilitate separating the costs of AID's basic operating functions from those costs directly associated with programs. Operating expenses are used to pay the salary costs of USAID/Kenya local national employees and the support costs which include rents, utilities, furnishings, equipment, in-country travel, supplies and services obtained locally.

USAID/Kenya oversees the operating expense budget and provides partial support to employees of the Regional Economic Development Services Office, the Regional Financial Management Center, USAID/Kenya, the Regional Inspector General's Office, and the Regional Housing Office (RHUDO). RHUDO also receives operating funds from program sources. In this report we use the term USAID/Kenya to include all Agency operations in Kenya including the regional offices named above.

AUDIT OBJECTIVE AND SCOPE

The objective of this audit segment was restricted to addressing the establishment of a trust fund to finance certain USAID/Kenya operating and support costs. Thus, local currency generated by Commodity Import Programs (CIP) would be substituted for appropriated dollars.

The field work was done between March and June 1985. We interviewed employees and reviewed records at USAID/Kenya. We also communicated with six other USAIDs to determine whether they were making use of trust funds. During the period from October 1, 1981 to September 30, 1984 a total of $18.6 million in operating expenses was obligated. This report discusses the feasibility of financing annual costs of approximately $1.3 million. Our audit was made in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

At the time of our review, USAID/Kenya had not established a trust fund to pay operating costs with local currency generated from AID non-project assistance. The Foreign Assistance Act of 1961, as amended, (FAA) requires the recipient country to establish a Special Account and make available no less than 10 percent of generated funds for requirements of the U.S. Government. At the time of our review, USAID/Kenya had not opened negotiations for a trust fund because they believed that the Government of Kenya (Government) would oppose it. Consequently, appropriated funds estimated at $1.3 million annually were spent for operating expenses. These expenses might have been financed with local currency generations, if the GOK approved and funded an operating expense trust fund.

AID provides non-project assistance, in the form of commodities financed through CIP and Public Law 480, to many countries. When provided on a grant basis, this type of assistance usually generates local currency funds used for different purposes. Two pertinent sections of the FAA are particularly relevant.

According to parts of Section 609 of the FAA, "...in cases where any commodity is to be furnished on a grant basis under chapter 4 of part I under agreements which will result in the accrual of proceeds to the recipient country from the sale thereof, the President shall require the recipient country to establish a Special Account, and (1) deposit in the Special Account, under terms and conditions as may be agreed upon, currency of the recipient country in amounts equal to such proceeds; <u>(2) make available to the United State Government such portion of the Special Account as may be determined by the President to be necessary for the requirements...such portion shall not be less than 10 per centum...and, (3) utilize the remainder...for programs agreed to by the United States Government...</u>" (Underscore added).

Sub-paragraph (h) Section 636, of the FAA states that "...<u>the President shall take all appropriate steps to assure that, to the maximum extent possible, (1) countries receiving assistance under this Act contribute local currencies to meet the cost of contractual and other services rendered in conjunction with such programs, and (2) foreign currencies owned by the United</u>

States are utilized to meet the costs of such contractual and other services" (Underscore added).

Thus, when non-project assistance agreements are concluded with host governments, local currency generated under these agreements, can be used to pay certain Agency operating expenses. For example, the CIP is often funded on a grant basis with appropriated dollars. The appropriated dollars are used to pay U.S. suppliers for commodities, equipment, and/or machinery which are exported to a recipient country. Within the recipient country, the equivalent of the U.S. dollar disbursements is generated as local currency. Since the program, in this example, is on a grant basis, a host government uses part of the locally generated currencies on AID approved development projects. Likewise, a minimum of 10 percent of locally generated currencies should be used to pay certain AID operating and support costs such as rents, maintenance, in-country travel, and local salaries.

As a result of appropriated fund constraints, the Agency circulated, on February 15, 1985, a worldwide cable (State 046714) which reflected the Fiscal Years 1985 and 1986 operating expense funding levels and urged missions to reduce appropriated fund requirements. In part, it stated that "All missions that do not have trust fund arrangements with the host country should initiate a serious dialogue for obtaining such funds. As a minimum, any country having Cash Transfers or CIP Grants should be providing trust funds to support a portion of our operating expense local currency costs...."

Six countries within RIG/A's area of audit responsibilities had signed trust fund agreements with the respective USAIDs whereby a percentage or fixed amount of the locally generated currencies is provided to pay for certain costs. However, at the time of our audit, USAID/Kenya had not negotiated a trust fund agreement with the Government. USAID/Kenya officials told us that they had not pursued the matter because they believed that Kenyan officials would oppose such an arrangement.

USAID/Kenya estimated that the Commodity Import and Fertilizer Programs, which were signed during Fiscal Years 1984 and 1985, will generate the local currency equivalent of $53.0 million. We identified costs totalling about $1.0 million which had been paid with appropriated funds. These costs could have been paid with local currencies had USAID/Kenya negotiated a trust fund agreement. They included such items as local salaries, overtime, local health insurance, severence pay, rentals, repairs, utilities, and local contracts. Thus, USAID/Kenya's failure to negotiate such an agreement resulted in the expenditure of limited appropriated funds. The successful negotiation of an accord will alleviate certain constraints in appropriated funds.

On March 20, 1985, we advised USAID/Kenya that, if a trust fund was negotiated with the GOK, appropriated U.S. dollars could be saved. Our draft report, submitted to USAID/Kenya in August 1985, made this a formal recommendation.

Negotiations were initiated in December 1985 as part of the Fiscal Year 1986 Commodity Import Program. The records show a number of meetings held between USAID/Kenya and the Government covering the procedures and mechanics of the trust fund. For example, at the initial stages, the Government did not quite understand how the trust fund worked. After the appropriate explanations were made, the Government expressed basic agreement with the procedures. In a meeting held on February 21, 1986, the first topic of discussion was the trust fund agreement. The Government representative stated that they understood the AID position regarding the establishment of a trust fund into which counterpart Shillings would be deposited to be used to cover the administrative costs of bilateral mission. They realized that it was a condition to the signing of the ESF agreement and did not anticipate any difficulties obtaining clearances for such an agreement. Accordingly, we have amended our original recommendation as follows.

RECOMMENDATION

We recommend that USAID/Kenya conclude negotiations with the Government of Kenya on the establishment of a trust fund to cover local currency operating expenses.

In responding to our draft report, the Director, USAID/Kenya agreed with our recommendation. As stated previously, negotiations with the Government of Kenya were progressing satisfactorily at the time this report was released. According to a USAID/Kenya Official, an estimated $1.3 million in operating expenses will be financed from local currency trust funds.

The Office of Regional Inspector General For Audit in Nairobi believes that USAID/Kenya's efforts to negotiate a trust fund agreement to cover local currency operating expense are fully responsive to our recommendation. However, this recommendation will remain open until such an agreement has been finalized.

We would appreciate written notice within 30 days of any additional information related to action planned or taken to implement the recommendation.

APPENDIX A

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