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AUDIT OF
KENYA ON-FARM GRAIN STORAGE PROJECT
PROJECT NO. 615-0190

AUDIT REPORT 3-615-87-6
DECEMBER 9, 1986

UNITED STATES OF AMERICA

AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT

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December 9, 1986

MEMORANDUM FOR DIRECTOR, USAID/KENYA, Steven W. Sinding

FROM: RIG/A Nairobi, Richard C. Thabet

SUBJECT: Audit of Kenya On-Farm Grain Storage Project

This report presents the results of audit of the Kenya On-Farm Grain Storage Project. The audit included program results, economy and efficiency, and compliance issues. The audit objectives were to determine if (1) the project's technology reduced on-farm stored grain losses, (2) USAID/Kenya carried out the project as economically as possible, and (3) USAID/Kenya and the contractor complied with AID regulations and provisions of the technical assistance contract.

The project appeared to successfully reduce on-farm stored grain losses. However, the audit showed that the project was not carried out as economically as possible and that USAID/Kenya and the technical assistance contractor were not complying with certain AID regulations and contract provisions.

Actual or potential unnecessary costs and instances of non-compliance were attributed to plans to replace the loan project with a grant, non-reimbursement from the GOK for tax and duty payments, incorrect recording of the commitment ceiling for the technical assistance contract, and inadequate controls over project construction approval.

To correct these problems, the report recommends that the Director, USAID/Kenya (1) enter into negotiations with the host government to either use loan funds or a combination of grant and loan funds on future project activities, (2) obtain a Kshs. 719,560 ($45,000) reimbursement for tax and duty payments, (3) reduce by $100,000 the commitment for the technical assistance contract, and (4) tighten controls over construction approvals.

USAID/Kenya agreed to implement all of these recommendations. In some cases, corrective actions had been completed or started before the final report was issued.

Please advise me within 30 days of any additional information related to action planned or taken to implement the recommendations. Thank you for the courtesies extended to my staff during the audit.

EXECUTIVE SUMMARY

The purpose of the Kenya On-Farm Grain Storage Project was to increase the use of more effective on-farm grain drying and storage practices in Kenya. The project loan agreement, which was signed on June 4, 1981, was scheduled for completion on June 4, 1988. Planned AID financing over the life of the loan project was $7.8 million of which $6.8 million was allocated to a technical assistance contract.

The staff of the Regional Inspector General for Audit, Nairobi conducted an audit of the project which included program results, economy and efficiency, and compliance issues. The audit objectives were to determine if (1) the project's technology reduced on-farm stored grain losses, (2) USAID/Kenya carried out the project as economically as possible and (3) USAID/Kenya and the contractor complied with AID regulations and provisions of the technical assistance contract.

The project appeared to successfully reduce on-farm stored grain losses. Technical reports on field trials showed the project met its objective of reducing small farmers' grain losses by 50 percent.

However, the audit identified four substantive areas where the project was not carried out as economically as possible or where USAID/Kenya and the technical assistance contractor were not complying with certain AID regulations and contract provisions.

First, in conformance with AID project development policy, the Kenya On-Farm Grain Storage Project was established as a loan in 1981. However, based on subsequent Government of Kenya objections to paying expatriate technical assistance staff with funds that must eventually be repaid, USAID/Kenya planned to deobligate unused loan funds and create a new grant project. In light of U.S. budget constraints, the success of the project, and GOK support for the project, a loan arrangement was even more appropriate at the time of the audit than it was when the project was first approved. By replacing the loan project with a new country-wide grant project, AID will forfeit the U.S. Government's ability to recoup $7.5 million in principal repayments plus interest. This loss was attributed to the fact that, USAID/Kenya had not reopened negotiations with the GOK to reconsider the options of (1) keeping the project as a loan, (2) developing a similar country-wide project as a loan or (3) devising a partially grant funded project.

The report recommends that the Director, USAID/Kenya enter into negotiations with the Government of Kenya to either use loan funds or a combination of grant and loan funds on future project activities. USAID/Kenya management agreed to discuss with the host government the possibility of a combination grant and loan funded project but expressed concern over any limitations to their options for a final decision.

Second, AID policy prohibited AID from financing any host country taxes placed against a contractor. However, the Government of Kenya did not reimburse the Mission for taxes and duties paid in 1982 on project construction materials. This debt was still outstanding at the time of the audit because the Mission did not follow up on its December 1982 request for payment. As a result, the U.S. Government lost $93,000 in principal and unrecoverable losses attributable to foregone interest and penalty payment collections and the devaluation of the Kenya Shilling.

The report recommends that, USAID/Kenya issue a bill of collection for Kenya Shillings 719,560 or deduct this amount from the regenerated Kenya Shilling account. USAID/Kenya management agreed with this recommendation.

Third, AID regulations prohibited recording obligations in excess of the total estimated payments under cost reimbursement contracts. However, USAID/Kenya inadvertently recorded the $6.8 million technical assistance contract as a $6.9 million commitment. As a result, the U.S. Government could incur a potential loss of $100,000.

The report recommends that the Director, USAID/Kenya ensure that the Mission accounting system be revised to reflect the correct amount of the contract. USAID/Kenya management agreed with this recommendation.

Fourth, AID procedures required that construction proposals compare construction costs against leasing costs to determine the most cost effective method of acquiring real estate. However, USAID/Kenya entered into a contract to construct housing for technical personnel without performing such a cost comparison or conducting a formal survey to determine if rental property was available in the project area. No conclusive information on the availability of rental property could be obtained during the audit. However, there were some indications that rental housing was available and, consequently, USAID/Kenya may have made an estimated $ 171,000 in unnecessary expenditures.

The report recommends that USAID/Kenya tighten controls over construction approvals. Although USAID/Kenya management did not agree that they made unnecessary expenditures, they agreed with this recommendation.

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PART I - INTRODUCTION

A. Background

The purpose of the Kenya On-Farm Grain Storage Project was to increase the use of more effective on-farm grain drying and storage practices in Kenya. A specific objective was to reduce by 50 percent the grain losses from birds, insects, molds and rodents for small farmers adopting project technologies.

The project loan agreement was signed on June 4, 1981 with an original completion date of June 4, 1986. This date was subsequently extended to June 4, 1988. The project was administered by the Agriculture Office, USAID/Kenya. However, the bulk of project activity was implemented by Development Planning and Research Associates, Inc. under a technical assistance contract.

Planned AID financing over the life of the loan project was $7.8 million of which $6.8 million was allocated to the technical assistance contract. As of September 30, 1986, $3.1 million in AID funds had been expended. The Government of Kenya (GOK), through the Ministry of Agriculture and Livestock Development, agreed to provide the equivalent of $3.9 million representing a 33 percent project contribution.

B. Audit Objectives and Scope

The staff of the Regional Inspector General for Audit, Nairobi (RIG/A/N) conducted the audit which included program results, economy and efficiency, and compliance issues. The audit objectives were to determine if:

-- the project's technology reduced on-farm stored grain losses,

-- USAID/Kenya carried out the project as economically as possible and

-- USAID/Kenya and the contractor complied with AID regulations and provisions of the technical assistance contract.

To accomplish these objectives, RIG/A/N staff conducted this review from July to October 1986 in Nairobi and the Western and Nyanza Provinces of Kenya. The audit covered project activity from June 1981 through September 30, 1986. The audit staff (1) reviewed USAID/Kenya, AID Regional Finance Management Center (RFMC), and contractor project and accounting files; (2) interviewed officials of USAID/Kenya, RFMC, the technical assistance contractor and the GOK in Nairobi and the two provinces; (3) performed limited tests of USAID/Kenya's and the technical assistance contractor's internal controls and (4) reviewed a prior RIG/A/N audit report on the project.

The review included $3.1 million or 40 percent of the total authorized loan funding under the project. The exact amount of funding which received detailed testing could not be determined since, as discussed in the "Compliance and Internal Control" section of the report, project subcomponents were not broken out in the accounting system.

The audit did not include an audit of counterpart funds which may be the subject of a future audit. Further, the audit did not include independent verification of technical reports showing the decreases in grain storage losses attributed to the project's technologies. A detailed analysis of the methodology and the voluminous technical data for the field trials, which were completed in September 1985, was well beyond the technical expertise of the audit staff. However the results contained in these reports were consistent with favorable responses by representatives of the GOK, local farmers, USAID and the technical assistance contractor.

The audit was made in accordance with generally accepted Government auditing standards.

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PART II - RESULTS OF AUDIT

The project appeared to successfully reduce on-farm stored grain losses. However, the audit showed that the project was not carried out as economically as possible and that USAID/Kenya and the technical assistance contractor were not complying with certain AID regulations and contract provisions.

Technical reports on field trials showed the project met its objective of reducing small farmers' grain losses by 50 percent. The audit staff also observed enthusiasm for project results from GOK officials, a small group of farmers, USAID personnel, and technical assistance contractor representatives.

Actual or potential unnecessary costs were attributed to (1) plans to replace the loan project with a grant, (2) non-reimbursement from the GOK for tax and duty payments, (3) incorrect recording of the commitment ceiling for the technical assistance contract, and (4) inadequate controls over project construction approval. Non-compliance issues included the lack of AID emblems on project vehicles and demonstration units and the lack of separate accountability in the mission accounting system for such project components as participant training and commodities.

To correct these problems, the report recommends that USAID/Kenya (1) reevaluate its decision to replace the loan project with a grant, (2) recover funds expended under the project for duties and taxes, (3) decrease the commitment ceiling of the technical assistance contract, and (4) tighten controls over construction approvals. Since management agreed to resolve the compliance issues, the report does not contain formal recommendations regarding these matters.

A. Findings and Recommendations

1. AID Could Save the U.S. Government Millions of Dollars by Not Replacing the Loan Project With a Grant

In conformance with AID project development policy, the Kenya On-Farm Grain Storage Project was established as a loan in 1981. However, based on subsequent Government of Kenya objections to paying expatriate technical assistance staff with funds that must eventually be repaid, USAID/Kenya planned to deobligate unused loan funds and create a new grant project. In light of U.S. budget constraints, the success of the project, and GOK support for the project, a loan arrangement was even more appropriate at the time of the audit than it was when the project was first approved. By replacing the loan project with a new country-wide grant project, AID will forfeit the U.S. Government's ability to recoup $7.5 million in principal repayments plus interest. This loss was attributed to the fact that, USAID/Kenya had not reopened negotiations with the GOK to reconsider the options of (1) keeping the project as a loan, (2) developing a similar country-wide project as a loan or (3) devising a partially grant funded project.

Recommendation No. 1

We recommend that the Director, USAID/Kenya, in consultation with AID/Washington, enter into negotiations with the Government of Kenya to either:

a. retain the current Kenya On-Farm Grain Storage project as a loan,

b. develop a similar country-wide loan project, or

c. devise a combination grant and loan funded project using a portion or all of the grant funds for payment of expatriate expenses.

Discussion - AID Handbook 1, Part V-1 stated that "It is AID policy to use all FAA resources as efficiently as possible .... The question of whether loan or grant assistance is more appropriate for a development problem requires consideration of such factors as (1) the LDC's financial condition, particularly its repayment capacity; (2) the purpose of the financing (e.g. grants are often preferred for pilot or innovative projects and research); (3) the profitability and economic value of the project (if high, there is more justification for loan financing), (4) the cost of the project (if too high, sufficient grant funds are not likely to be available), and (5) the overall U.S. aid strategy for the country."

In light of this criteria, Kenya was a good candidate for loan projects which undoubtedly was the justification for establishing the Kenya On-Farm Grain Storage project as a loan in 1981. First, Kenya was, economically, one of the strongest countries in Africa. Second, as shown in Figures 1 and 2, the project involved modifying grain storage techniques that have long been used by Kenyan farmers rather than introducing a pilot or innovative project or research. Further, what research was involved in the project has been, or soon will be, completed in Western and Nyanza provinces.

Third, the economic value of the project was high since grain production has traditionally been the most important aspect of the Kenyan economy. Fourth, the cost of the project was high at $7.8 million. Fifth, the overall U.S. aid strategy to Kenya has historically involved loans which represented $224.7 million or 36 percent of total economic assistance from 1962 to 1985.

Recently, however, the GOK objected to the use of loan funds for technical assistance provided by expatriates. As a result, the GOK requested that AID consider a transition from a loan funded project to one using grant funds. In February 1986, the former Director, USAID/Kenya verbally agreed to deobligate, after a transition period, available loan project funds and seek grant funding for a new $7.5 million country-wide project to be built on the foundation laid by the current project.

In light of three recent events, project loan funding was even more appropriate at the time of the audit than it was when the project was first approved in 1981. First, at the time of our review, the U.S. Government was in the midst of a budgetary crisis that may last for several years into the future. In an August 1986 cable to all Ambassadors, Charges, and Principle Officers, the acting Secretary of State stated that:

> "We face a national security crisis. Proposed Congressional cuts in the international affairs budget will seriously jeopardize our national security interests and global foreign policy objectives.... Congressional reductions... and earmarking of AID levels in several key countries, will mean a cut of 50 to 60 percent for our foreign assistance programs in the remaining countries [such as Kenya]."

Replacing a loan project with a grant project during a period of budget reductions will eliminate a source of revenue to the U.S. Government that could help ease future budgetary constraints.

Second, according to the technical assistance contractor's records, project demonstrations in Nyanza and Western Provinces were successful. A January 1986 contractor report presented technical data showing that the project was meeting its goal of reducing on farm grain storage losses by 50 percent.

Fig. 1 Demonstration units at the project laboratory site. Left front unit is unimproved traditional style. Other units have been slightly modified.

Fig. 2 Two improved demonstration units on a farm in Western Province.

The technology will soon be ready for replication in other parts of Kenya. A strong argument could be made for loan funding when a project moves from the demonstration phase to the replication phase.

Third, the GOK showed support for the project at the time of the audit. Previously, top level GOK officials criticized the project stating that AID was not offering anything new and that Kenyan farmers had been utilizing the project's storage techniques for hundreds of years. It was subsequently understood that the project was modifying existing storage techniques to produce substantial results. Since the project was later viewed as an important factor in the GOK's objective of increased agricultural output, a loan arrangement was more viable at the time of the audit than it was when the decision was made to create a new grant project.

By replacing the loan project with a grant, AID will forfeit the U.S. Government's ability to recoup $7.5 million in principal payments plus interest. This loss was attributed to the fact that USAID/Kenya had not reopened negotiations with the GOK in light of the three recent events discussed above. Specifically, the mission had not recently explored with the GOK the options of keeping the existing project as a loan, developing a similar country-wide project as a loan, or devising a partially grant funded project.

The first option would involve maintaining the existing loan agreement but modifying the project's scope. Such a modification could include expansion of the project's geographic regions.

The second option would simply change the proposed funding for the new project from a grant to a loan. The final option would provide for both grant and loan funding for the new project. Since using loan funds to pay for expatriate technical assistance staff was the GOK's primary objection, the new project could be structured in a way that a portion or all of the grant funds would be used for payment of expatriate expenses.

In conclusion, USAID/Kenya needs to re-evaluate its decisions to terminate the Kenya On-Farm Grain Storage Project loan and create a grant project in its place. Maintaining the project as a loan would help the U.S. Government meet the challenge of upcoming budgetary constraints. Further, GOK acceptance of the change would be facilitated by the recent success of, and GOK support for, the project.

Management Comments

USAID/Kenya stated that it was inappropriate for RIG/A/Nairobi to make a recommendation requiring the mission to loan fund or have a combination loan/grant funding for a project. They added that this was a management decision between the mission and AID/W. However, they agreed to surface the possibility of a combination grant and loan funded project in their on-going discussions with the GOK. The Mission also requested word changes which resulted in revisions to the final report.

Office of Inspector General Comments

The Mission initially misunderstood Recommendation No. 1. During a subsequent discussion with the Deputy Director, USAID Kenya, it was agreed that the report recommends that the Mission "enter into negotiations with the Government of Kenya [underscoring added]" to achieve one of the three options included in the recommendation. When the Mission does in fact make a good faith effort to achieve one of these options, the recommendation can be closed even if the negotiations are unsuccessful.

In addition, we reworded Recommendation No. 1 to allow more flexibility in how grant funds could be used under a combination loan and grant funded project. We also added to the recommendation the need to consult with AID/W on the future negotiations with the GOK.

2. The Government Of Kenya Owes USAID/Kenya For Taxes And Duties Paid On Construction Materials

AID policy prohibited AID from financing any host country taxes placed against a contractor. However, the Government of Kenya did not reimburse the Mission for taxes and duties paid in 1982 on project construction materials. This debt was still outstanding at the time of the audit because the mission did not follow up on its December 1982 request for payment. As a result, the U.S. Government lost $93,000 in principal and unrecoverable losses attributable to foregone interest and penalty payment collections and the devaluation of the Kenya Shilling.

Recommendation No. 2

We recommend that the Director, USAID/Kenya direct the:

a. issuance of a bill of collection to the Government of Kenya for Kshs. 719,560; or

b. recovery of Kshs. 719,560 from the regenerated Kenya Shilling account.

Discussion - AID Handbook 11, Appendix A stated that "AID will not finance... identifiable taxes, fees, levies or impositions under the laws of the host country placed against a contractor ...." Further, Annex 2 of the Project Loan Agreement stated that the "Agreement and the Loan will be free from ... any taxation or fees imposed under laws in effect in the territory of the Borrower."

A construction contractor paid Kshs. 719,560 ($45,000) in taxes and duties on construction materials for the project's laboratory and housing units. USAID/Kenya, in making progress payments to the contractor, paid the costs of these taxes and duties. On December 7, 1982, the Mission issued Implementation Letter No. 4 requesting a reimbursement from the GOK for Kshs. 719,560. As of September 30, 1986, USAID/Kenya had not received this reimbursement.

We found that there was no Mission follow-up on this original request for payment. Our review of project files and discussions with Mission officials showed that USAID/Kenya did not issue a bill of collection or initiate further correspondence with the GOK on this matter.

The lack of USAID/Kenya follow-up on this outstanding debt resulted in a loss of about $93,000. Of this total, about $45,000 (KShs. 719,560) in the original principal was recoverable if corrective action were taken. The remainder was an unrecoverable loss made up of foregone interest and penalty receipts and the devaluation of the Kenya Shilling.

AID Handbook 19 allows missions to collect both interest and penalties on outstanding debts based on the due date of the bill of collection. Since USAID/Kenya did not issue a bill of collection, it gave up the right to collect $20,000 in interest and $8,000 in penalties.

Further, the mission lost an additional $20,000 through the devaluation of the Kenya Shilling. Based on the December 7, 1982, exchange rate of Kshs. 11.02 = $1.00, Kshs. 719,560 had a corresponding value of about $65,000. However, since the value of the Kenya Shilling declined to Kshs. 16.08 = $1.00, those same Kshs. 719,560 were only worth $45,000 as of September 30, 1986.

In conclusion, AID should take immediate steps to obtain a reimbursement for the taxes and duties paid on the project construction materials or recover the amount owed from the regenerated Kenya Shilling account.

<u>Management Comments</u>

USAID/Kenya agreed with Recommendation No. 2. Recovering the amount due from the regenerated Kenya Shilling account had already been discussed with an official of the GOK Ministry of Finance. A letter formally proposing this to the GOK was in the clearance process in November 1986.

3. The Mission Incorrectly Recorded The Commitment Ceiling For The Technical Assistance Contract

AID regulations prohibited recording obligations in excess of the total estimated payments under cost reimbursement contracts. However, USAID/Kenya inadvertently recorded the $6.8 million technical assistance contract as a $6.9 million commitment. As a result, the U.S. Government could incur a potential loss of $100,000.

Recommendation No. 3

We recommend that the Director, USAID/Kenya ensure that the Mission accounting system be revised by reducing the commitment amount for the Kenya On-Farm Grain Storage Project's technical assistance contract from $6.9 million to $6.8 million.

Discussion - Section 2F1F(4) of AID Handbook 19 stated that, "obligations for cost reimbursement contracts are recorded for the amount of the total estimated cost or payments shown or provided for in the contract, but not in excess, ... including the fixed fee in the case of cost plus fixed fee contracts."

The GOK and the technical assistance contractor entered into a cost reimbursable plus fix fee type contract totaling $6.8 million. Under the terms of the contract USAID/Kenya, acting as the GOK's agent, made payments to the contractor for reimbursable costs.

One internal control feature to prevent excessive payments to contractors was the establishment of commitment ceilings by contract within the Mission Accounting Systems (MACS). However, the project's technical assistance contract was inadvertently recorded as $6.9 million.

We concluded that this incorrect entry was attributable to human error. Unless corrected, however, USAID/Kenya could disburse $100,000 in excess of the authorized contract amount if the contractor submits excessive reimbursement requests of $6.9 million or more.

To prevent this potential loss, USAID/Kenya needed to make a correcting entry in the MACS to de-commit $100,000 for the technical assistance contract.

Management Comments

USAID/Kenya agreed with Recommendation No. 3. A journal voucher entry was posted in the Mission accounting system on October 30, 1986 to de-commit the $100,000 in excess funds from the Mission's Direct Reimbursement Authority. Since the adjusting entry was reflected in the Mission's November financial reports, we closed this Recommendation effective as of the date of our final report.

4. USAID/Kenya Needs Tighter Controls Over Project Construction Approvals

AID procedures required that construction proposals compare construction costs against leasing costs to determine the most cost effective method of acquiring real estate. However USAID/Kenya entered into a contract to construct housing for technical personnel without performing such a cost comparison or conducting a formal survey to determine if rental property was available in the project area. No conclusive information on the availability of rental property could be obtained during the audit. However, there were some indications that rental housing was available and, consequently, USAID/Kenya may have made an estimated $ 171,000 in unnecessary expenditures.

Recommendation No. 4

We recommend that the Director, USAID/Kenya prepare a Mission Order requiring, prior to construction approvals for housing and other structures for AID projects, the execution of:

a. formal surveys of rental property;

b. comparisons of acquisition costs against leasing costs; and

c. certifications of non-availability of adequate and cost effective rental property.

Discussion - AID Handbook 23, Appendix 5A stated that:

> "In preparing an acquisition [of real estate] proposal for Washington consideration, posts should keep in mind certain basic policies which are applied by Congress, the Department, USIA, AID, GAO and OMB in reviewing acquisition proposals.
>
> All proposals are examined for economy. This is done basically by comparing acquisition costs...against the estimated long-range leasing costs."

Such a cost comparison was not included in the project's construction proposal for technical assistants' housing. In fact, the project paper contained contradictory statements regarding the availability of existing housing. On page 10, the project paper stated that, "Technicians will reside approximately 28 KM from Maseno in Kisumu which is the third largest city in Kenya and which can provide adequate housing, schooling, and marketing for the technicians and their families [underscoring added]." On page 32, the same document states that, "For this project, five technicians will live in Kisumu/Maseno and one in Kakamega. Recent experience, both with AID financed projects and other donor projects, indicate that <u>suitable rental housing will be unavailable</u> in the two towns; therefore, AID will finance the construction of the houses [underscoring added]."

We reviewed project files and found no documentation showing that a formal survey of rental property was performed in the project area. Mission officials stated that the question of expatriate housing was considered in depth, but they could not provide any written material describing real estate survey procedures or results.

Due to the lack of a formal rental property survey and a comparative cost analysis of constructing versus renting the housing units, USAID/Kenya may have incurred unnecessary costs. The audit staff could not obtain prior information on rental property available at the time the technical assistance team arrived in 1984. However, the current technical assistance team leader informed us that rental property was available when he moved into the AID constructed housing and that he would have preferred living in other quarters.

We acknowledge that this information is not conclusive. However, if true, we estimate that AID may have made $ 171,000 in unnecessary loan fund expenditures (this represents total estimated construction expenditures less estimated rental payments).

In conclusion, AID/Kenya needs to implement procedures to ensure that formal surveys of rental property, comparisons of acquisition costs against leasing costs, and certifications of non-availability of adequate and cost effective rental property are executed prior to approval of project construction. This will remove any future doubts as to whether expenditures for project construction are needed.

<u>Management Comments</u>

USAID/Kenya concurred with Recommendation No. 4 and was in the process of clearing the required draft Mission Notice. However, management did not agree that USAID/Kenya made an estimated $171,000 in unnecessary expenditures by constructing housing in Kisumu. Management acknowledged that the technical assistance contractor team leader stated that adequate rental property might have been available at the start of the project. However, they stated that other expatriates disagreed with the team leader's views on the availability of housing and that we should have talked with a larger sample of expatriates.

Office of Inspector General Comments

Both the draft and final reports clearly stated that conclusive information on the availability of rental property could not be obtained during the audit. However, as noted in the report, page 10 of the project paper stated that "Technicians will reside approximately 28 Km from Maseno in Kisumu which is the third largest city in Kenya and which can provide adequate housing,... [underscoring added]." This statement combined with the team leader's comments, cast a cloud over the need for the estimated $171,000 in housing expenditures. Implementing our recommendation would remove any future uncertainity over the need for housing construction. Further, we revised the report sentence in question to say that "... USAID/Kenya may have made an estimated $171,000 in unnecessary expenditures.

B. Compliance and Internal Control

Compliance

As discussed in the "Findings and Recommendations" section of the report, USAID/Kenya did not follow AID regulations which required (1) comparisons of acquisition costs against leasing costs in construction proposals, (2) issuance of bills of collection, including interest and penalty charges on outstanding debts, and (3) accurate recordation of commitments for contracts. The report makes recommendations to remedy these non-compliance issues.

Since management agreed in writing to correct the following two non-compliance issues, the report does not make formal recommendations in these areas. First, the general conditions to the technical assistance contract required that "the contractor shall insure that all equipment and materials... carry the official AID... emblem." The audit found, however, that project vehicles and grain storage demonstration units were not marked with the AID emblem.

Second, Section 8E4d of AID Handbook 19 required accounting implementation at a project input level, i.e., commodities training, etc. However, neither the project officer's records nor the Mission Accounting Control System (MACS) maintained separate accountability by project component for the Kenya On-Farm Grain Storage Project.

Other items tested were in compliance with applicable laws, regulations, and the technical assistance contract. Nothing came to the auditors' attention that caused them to believe the untested items were not in compliance with applicable laws and regulations.

Internal Control

We performed limited tests of USAID/Kenya's and the technical assistance contractor's sets of internal controls including a sample of financial transactions recorded by the contractor's accounting firm. Generally, internal controls appeared adequate for the items tested. One exception noted in Finding No. 3 was the incorrect recording of the commitment amount for the technical assistance contract. This could potentially result in a $100,000 overpayment to the contractor.

AUDIT OF
KENYA ON-FARM GRAIN STORAGE PROJECT.

PART III - APPENDICES

UNITED STATES GOVERNMENT

memorandum

DATE: November 7, 1986

REPLY TO ATTN OF: Steve Sinding, Director, USAID/Kenya

SUBJECT: Draft Audit Report of On-Farm Grain Storage Project - No. 615-0190

TO: Richard Thabet, Director, RIG/A

Recommendation No.1.

> "We recommend that the Director, USAID/Kenya enter into negotiations with the Government of Kenya to either (a) retain the current Kenya On-Farm Grain Storage Project as loan, (b) develop a similar country-wide loan project, or (c) devise a combination grant and loan funded project using grant funds solely for payment of expatriate expenses."

We believe it is inappropriate for RIG/A/Nairobi to make a recommendation requiring USAID/Kenya to loan fund or have a combination loan/grant funding for a project. This is a management decision between the mission and AID/W. However, we have no objection to RIG stating their opinion as to whether they concur or do not concur in our use of loan/grant funds. Since USAID/K has already indicated to the GOK our intention to grant fund the proposed new project, we believe the recommendation as worded is inappropriate and cannot be closed.

We agree that it may be useful to surface the possibility of a combination grant and loan funded project in our on-going discussions with the GOK and plan to present the possibility of option C to the GOK when we again discuss the future of the On-Farm Grain Storage Project. The decision to proceed with Phase II depends on the recommendations of the evaluation to be carried out in January 1987. Even though we may again consider the grant/loan funding option within the context of the present project, we maintain that we must reserve the option to grant fund the entire proposed new project particularly if the policy reforms attained warrant grant funding. The mission position on the role of grant funding in the proposed new project remains unchanged from the September 25, 1986 memo on this topic.

On page (ii) we recommend that the fourth sentence in the second paragraph be changed to the following:

"By converting the loan project to a new country-wide grant project, AID will in our opinion, unnecessarily forefeit the USG's ability to collect $7.5 M in principal repayments plus interest". This correction should also be made in the first sentence of the last paragraph on page 11.

On page (ii) we believe the last sentence is inaccurate. The draft report states that "... USAID/K has not explored with the GOK options ...". We have in fact explored these options.

Recommendation No. 2.

> "We recommend that the Director, USAID/Kenya direct the:
>
> A. issuance of a bill of collection to the Government of Kenya for KShs. 719,560; or
>
> B. deduction of KShs. 719,560 from future Economic Support Funds or other payments to the Government of Kenya."

As indicated in my last memo, we proposed to:

1. Request direct reimbursement from the GOK, or

2. Recover the amount due from the regenerated Kenya Shilling account.

Recovering the amount due from the regenerated Kenyan Shilling account, specifically the Local Currency Trust Fund Account No. 72-FT-800, has been discussed with an official of the Ministry of Finance. We have received a preliminary indication that the GOK would prefer this approach, and recovery from the trust account may be the most appropriate way to handle the matter. A letter proposing this to the GOK is in the clearance process.

Recommendation No. 3.

> "We recommend that the Director, USAID/Kenya ensure that the Mission accounting system be revised by reducing the obligated amount for the Kenya On-Farm Grain Storage Project's technical assistance contract from $6.9 million to $6.8 million."

The attached Journal Voucher was posted in the books on 30 October 1986 to de-earmark/de-commit the $100,000 excess funds from the Direct Reimbursement Authority (DRA). This adjustment will be reflected in the November financial status report on this project.

We have noted in section 3 on pages 19 and 20 that you have referred to the recording of the $6.9M as an obligation. In fact, the recording of the signing of the Project Agreement in MACS is the obligation, and the signing of a contract under the Pro Ag is referred to as a commitment. Therefore, we request that you change the reference from obligation to commitment as appropriate.

We also note on page 25, in the first paragraph, there is a reference to obligations which in fact should be changed to commitments. Again the same comment for the penultimate sentence on page 26 as a reference to obligation which should be changed to commitment.

Recommendation No. 4

> "We recommend that the Director, USAID/Kenya prepare a Mission Order requiring, prior to construction approvals for housing and other structures for AID projects, the execution of:
>
> (a) formal surveys of rental property;
>
> (b) comparisons of acquisition costs against leasing costs; and
>
> (c) certifications of non-availability of adequate and cost effective rental property."

A draft mission notice is developed and in the clearance process.

We concur that a mission notice on this topic will be useful in encouraging project designers to more fully document the process used to determine the necessity for construction. We do not agree that "USAID/Kenya made an estimated $171,000 in unnecessary expenditures" by constructing housing in Kisumu. Project financed housing was and still is essential in Kisumu. We have discussed the housing situation with a wide cross-section of expatriates living in Kisumu. Only one individual - The DPRA Team Leader - feels that adequate rental housing might have been available at the start of the project. At least one other member of the DPRA team takes strong exception to the Team Leader's views on the availability of housing. Had the investigating auditor talked with a larger sample of expatriates living in Kisumu we believe he would have assembed a different picture of the housing situation, and the merits of leasing versus construction for the long term benefit of Kenya.

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JOURNAL VOUCHER

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REFERENCE	EXPLANATION	DEBIT	CREDIT
	TO DE-EARMARK/DE-COMMIT EXCESS FUNDS. CONTRACT IS FOR $ 6.8 M --- EARMARKED AMOUNT IS CURRENTLY $6.9M GDAA-81-31615-AL19 72-11M1021 K150103 DRA-T-016-01		100,000
	TOTAL		

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List of Report Recommendations

Page

Recommendation No. 1

We recommend that the Director, USAID/Kenya, in consultation with AID/Washington, enter into negotiations with the Government of Kenya to either:

a. retain the current Kenya On-Farm Grain Storage project as a loan, — 4
b. develop a similar country-wide loan project, or
c. devise a combination grant and loan funded project using a portion or all of the grant funds for payment of expatriate expenses.

Recommendation No. 2

We recommend that the Director, USAID/Kenya direct the:

a. issuance of a bill of collection to the Government of Kenya for Kshs. 719,560; or — 9

b. recovery of Kshs. 719,560 from the regenerated Kenya Shilling account.

Recommendation No. 3

We recommend that the Director, USAID/Kenya ensure that the Mission accounting system be revised by reducing the commitment amount for the Kenya On-Farm Grain Storage Project's technical assistance contract from $6.9 million to $6.8 million. — 11

Recommendation No. 4

We recommend that the Director, USAID/Kenya prepare a Mission Order requiring, prior to construction approvals for housing and other structures for AID projects, the execution of:

a. formal surveys of rental property;

b. comparisons of acquisition costs against leasing costs; and — 12

c. certifications of non-availability of adequate and cost effective rental property.

APPENDIX 3

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