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AUDIT OF
REGIONAL FINANCIAL MANAGEMENT
CENTER, NAIROBI
COMPLIANCE WITH AID PAYMENT
VERIFICATION POLICY STATEMENTS

AUDIT REPORT NO. 3-615-87-11
MAY 29, 1987

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REGIONAL INSPECTOR GENERAL/AUDIT

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May 29, 1987

MEMORANDUM FOR RFMC Director, Harold W. Collamer



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

SUBJECT: Audit of Regional Financial Management Center (RFMC),
Nairobi Compliance with AID Payment Verification
Policy Statements

This report presents the results of audit of RFMC compliance with AID payment verification policy statements. Please provide written notice within 30 days of any additional information related to action planned or taken to implement the report recommendation. We appreciate the cooperation and courtesy extended our staff during the audit.

Background

In April 1982, the AID Administrator named a task force of AID senior officials to review the Agency's payment process. This action responded to congressional concern and audits conducted by AID's Inspector General and the General Accounting Office. The task force produced 16 policy statements on (a) methods of project implementation and financing, (b) verification, auditing and monitoring procedures, and (c) other procedures contributing to accountability. The Bureau for Management sent implementing guidance to the field on December 30, 1983.

Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Nairobi made a compliance audit at RFMC. The objective was to determine if RFMC complied with AID payment verification policy statements. Our examination of internal controls was limited to the extent discussed in the report relative to compliance with the policy statements. This audit was part of a worldwide effort led by the Inspector General's Office of Programs and Systems Audits (IG/PSA). Other information obtained at RFMC may be reported on by IG/PSA.

RFMC as well as USAID/Kenya and Regional Economic Development Services Office (REDSO) officials were interviewed and project files were examined. Eight projects were selected to test compliance with the policy statements (see Exhibit 1). Compliance was also tested by examining a sample of fiscal year 1986 vouchers and supporting documents. The audit included a review of general assessment reports sent to AID/W for calendar years 1983, 1984, 1985 and fiscal year 1986. The audit was conducted in November and December 1986 with subsequent follow-up work in February 1987 and was made in accordance with generally accepted government auditing standards.

Results of Audit

RFMC fully complied with 2 and partially complied with 10 AID payment verification policy statements. The remaining four statements did not require RFMC action.

Information developed by our worldwide audit indicated that recent RFMC annual reports on compliance with policy statements were much more comprehensive than the earlier reports. For example, reports were submitted for all client posts which addressed all statements applicable to the particular client post.

Nonetheless, within the policy statements, areas of non-compliance were identified during the audit which constitute material internal control weaknesses. Therefore, we recommended that RFMC prepare procedures for its staff as well as client posts to better comply with the policy statements.

RFMC Did Not Fully Comply With Payment Verification Policy Statements - To improve financial and administrative management, AID issued 16 payment verification policy statements. RFMC fully complied with 2 policy statements and partially complied with 10. This occurred because the Mission had not developed procedures or instructions to assure full compliance and implementation of the policy statements. Lack of full compliance could lead to increased mission vulnerability to mismanagement and abuse of project funds.

Discussion - RFMC compliance was required on 12 of the 16 statements. The remaining four statements called for action by AID/W and/or addressed issues not applicable to RFMC. RFMC fully complied with 2 policy statements and partially complied with 10.

The following sections discuss the extent of RFMC's non-compliance with the 10 policy statements. Exhibit 2 lists all 16 policy statements.

A. Policy Statements 1 through 5: AID missions are required to conduct annual assessments of their methods of implementation and financing and of host country contracting agency procedures for monitoring and invoice examination. Justifications are to be submitted by the missions for departures from the general policies of (1) using fixed amount reimbursement for financing multiple unit construction, (2) using federal reserve letters of credit for non-profit organizations, (3) using direct reimbursement procedures for funding host countries, contractors and suppliers and (4) using bank letters of commitment rather than direct letters of commitment except for commodity import programs and project commodity financing which are expected to involve many supplier invoices.

Host country contracting agencies are to be assessed as to their ability to (1) advertise, award and negotiate contracts, (2) monitor contract implementation, (3) examine invoices and (4) audit contractor records and reports. Also, the adequacy of host country accounting systems and arrival accounting systems for those countries with commodity import programs should be addressed. When local currency is provided to Intermediate Credit Institutions (ICI's) or when grants are awarded to indigenous Private Voluntary Organizations (PVOs), assessments should be made of their financial management procedures and related internal controls.

Initial submissions as well as updates for RFMC client posts including USAID/Kenya were late and incomplete. Only the most recent reports covering fiscal year 1986 were submitted on time. The initial submissions for RFMC client posts excluding Kenya were submitted almost seven months late. The first update covering the period ending December 31, 1984 was not submitted until August 7, 1985. It did not include Burundi, Djibouti or Rwanda. There were no update reports covering the period ending December 31, 1985. For USAID/Kenya, the initial report covering the period prior to December 31, 1983 was not made until September 18, 1985. With the exception of the current report covering fiscal year 1986, there were no other reports for Kenya.

None of the reports for RFMC client posts including USAID/Kenya adequately addressed host country contracts, commodity procurement and payment verification capability including ability to (a) advertise, award and negotiate contracts, (b) monitor contract implementation (c) examine invoices and (d) audit contractor records and reports. This is especially significant in view of the fact that RFMC client posts and USAID/Kenya had approximately \$85 million in host country contracts for current active projects. While the projects were active, it was possible that some of the contracts had expired. We were unable to readily make that determination.

While all recent reports (December 1986) attested to the adequacy of host country contracting we were unable to obtain documentary evidence from RFMC that host country contracting had been assessed per se as required by policy statements 5 and 9. Furthermore, earlier reports disclosed no evidence that host country contracting had been evaluated. RFMC officials agreed that host country contracting had not been addressed in detail in the reports because, for the most part, payments under host country contracts are made directly by AID thereby negating a lot of the problems normally associated with this form of contracting.

None of the reports submitted addressed the financial management procedures and related internal controls of indigenous PVOs. While we were unable to readily determine the number and amounts of contracts and grants made to indigenous PVOs by RFMC client posts, our review at the USAID/Kenya Population and Health office showed contracts and grants to major indigenous PVOs (over \$100,000 each) totaling approximately \$29 million. While some attempts had been made to assess the financial management capabilities and related internal controls for some of these PVOs, most of them had not been assessed.

In addition, the annual report for the most recent assessment of Malawi did not provide justification for use of bank letter of commitment as required under policy statements 3 and 4. According to the policy statements, a decision to use other than preferred methods of payment must be fully justified.

A review of eight Project Papers issued in six countries serviced by RFMC also showed numerous instances of inadequate compliance with Policy Statements 1 through 5 (see Exhibit 3). For example, six of the project papers did not show controller concurrence on the project data sheets. Two of the project papers did not follow the prescribed financing format. Two of the project papers did not address the adequacy of the host country commodity arrival accounting system where required. Also, two of the project papers did not adequately address host country contracting.

In addition, four of the project papers did not include an evaluation of the need for audit as required by Policy Statement 6. Also, funding was not provided for audit under four of the projects.

B. Policy Statement 8: Assessing Voucher Examination and Approval Procedures - Mission controllers were responsible for assessing annually USAID voucher examination and voucher approval procedures. The assessment was to indicate (a) adequacy of supporting documents submitted with contractor

invoices and (b) ability of project officers and authorized certifying officers to relate contractor performance with contractor invoices. The assessment was to include an examination of randomly selected vouchers. Areas of concern to the contractor as well as procedures that indicated high vulnerability were to be highlighted. Missions were to report the assessment results annually to AID/W.

The assessments were to be submitted with the general assessments required annually in connection with payment verification policy statements 1 through 5. As already addressed earlier, the reports were issued late. Furthermore, the assessments submitted were merely brief descriptions of the vouchering and paying processes and not assessments per se as required by Policy Statement 8. Areas of special concern as well as procedures which indicate relatively high vulnerability were not addressed by the assessments. None of the reports (a) described the sample of vouchers on which the assessments were based nor (b) disclosed problems identified or corrective actions proposed or taken in relation to those vouchers. There were no workpapers at RFMC supporting any of the annual assessments of voucher examination and approval procedures. In addition, the annual reports did not assess project and certifying officer ability to relate contractor performance with contractor invoices.

Audit of a sample of 53 Kenyan vouchers totaling approximately \$900,000 for fiscal year 1986 disclosed no problems with regard to supporting documents. However in all cases, we noted that USAID/Kenya continues to use the negative reassurance for administrative approval of vouchers. In 13 cases we noted that there were no administrative approvals. In 18 cases the checklists were not attached. In other cases the checklists were not adequately completed. Our review of 84 vouchers for Malawi and Zambia disclosed similar problems with regard to the administrative approval of vouchers but no problems were noted with regard to support. Policy statement 7 required, in lieu of the negative statements, that the project was to provide the controller a statement advising of the basis upon which administrative approval was given including an addendum checklist which indicates the number of visits to the project site, meetings with counterparts, etc.

In discussions with RFMC officials regarding compliance with AID's payment verification policies, they agreed that adequate compliance had not been achieved. To a large extent this was due to the fact that there was confusion as to what was required in terms of compliance. No RFMC internal procedures and guidance had been developed outlining staff responsibilities and action needed to fully comply with and implement the payment verification policy statements.

In addition, assessments of implementation of AID's payment verification policies were given a lesser priority because of the significance of other responsibilities in relation to available staff. Also, RFMC officials told us that they were understaffed in relation to the number of client posts serviced; they were in the process of converting from a manual system to the MACS system; and they did not have local staff with adequate experience. While we did not specifically address in this audit the adequacy of RFMC resources to fulfill its obligations, an earlier Audit Report No. 3-615-84-4 dated October 31, 1984 concluded that RFMC lacked the resources needed.

In conclusion, procedures and guidance are needed to better comply with and implement individual policy statements. Also, clarification and guidance is needed with regard to the administrative approval process. However since the latter issue will be addressed in a worldwide audit report on payment verification policies to be issued by IG/PSA, no recommendation is being made in this report.

Recommendation No. 1

We recommend that the Director, RFMC, develop procedures outlining staff responsibilities and actions needed to better comply with and implement payment verification policy statements.

RFMC comments were responsive to the draft report. As a result of close coordination between our officers, no disagreements remain outstanding. We have incorporated all suggested changes (see Appendix 1).

AUDIT OF
REGIONAL FINANCIAL MANAGEMENT
CENTER, NAIROBI
COMPLIANCE WITH AID PAYMENT
VERIFICATION POLICY STATEMENTS

EXHIBITS AND APPENDICES

Projects Selected To Test
Compliance With Payment Verification
Policy Statements

<u>Effective</u> <u>Date</u>	<u>Project</u>	<u>Project #</u>	<u>Country</u>	<u>Authorized</u> <u>(\$million)</u>
7/7/86	National Agr. Research	615-0229	Kenya	15.3
6/18/86	Family Planning Service	615-0232	Kenya	43.0
7/18/85	Agricultural Research	612-0215	Malawi	14.0
7/01/86	Regional Transport Dev.	690-0237	Malawi	10.5
8/30/86	Agricultural Survey and Policy Analysis	696-0126	Rwanda	7.0
3/25/86	CIP	642-K-605	Mauritius	5.9
9/22/86	Rural Economic Recovery	617-0108	Uganda	5.5
6/16/85	Agr. Rehab. Support	697-0101	Madagascar	7.8

Analysis Of Compliance with
Payment Verification Policy Statements

Policy Statement 1 - A comprehensive general assessment of methods of implementation and financing, reviewed from the standpoint of accountability, is to be presented on a regular basis and more specific assessments are to be included in Project Papers(PP).

Partially complied - See audit report text

Policy Statement 2 - AID/W Controller concurrence on the implementation and financing aspects are to be included in the general assessments and the more specific Project Paper assessments requiring AID/W review. In order to facilitate the AID/W review process, the USAID Controller concurrence should appear on the Project Data Sheet attached to the Project Paper and on the face sheet of the Project Assistance Approval Document(PAAD).

Partially complied - See audit report text

Policy Statement 3 -- As part of the assessments under Policy Statement 1, a justification is to be submitted whenever the mission proposes to depart from any of the following general policies.

- (a) The use of Fixed Amount Reimbursement (or modified Fixed Amount Reimbursement) as the preferred method in financing multiple unit construction.
- (b) Use of the Federal Reserve Letter of Credit procedure. Note that Federal Reserve Letters of Credit may be used only in the case of non-profit organizations. They cannot be used in any case for host country contracts or loan-financed contracts.
- (c) The use of the direct reimbursement procedure reimbursing the host country, contractors and others instead of other methods of payment which entail AID financial credit instruments to direct payments for contractors and suppliers.

Partially complied - See audit report text

Policy Statement 4 - As part of the assessments under Policy Statement 1, a justification is to be provided whenever the mission proposes use of the bank letter of commitment rather than the direct letter of commitment except for commodity import program and project commodity financing for which the mission anticipates a proliferation of invoices.

Partially complied - See audit report text

Policy Statement 5 - Where host country contracting is proposed as a means of implementation, the assessments required under Policy Statement 1 must set forth a realistic appraisal of the prospective contracting agency's ability to (a) advertise, award and negotiate contracts, (b) monitor contract implementation, (c) examine invoices, and (d) audit contractor records and reports. If local currency is to be made available to an intermediate credit institution or to any other organization responsible for controlling and reporting on the use of such funds, the mission should first assess the organization's financial management procedures and related internal controls. Such an assessment should also be performed as a prerequisite for providing grants to indigenous private voluntary organizations.

Partially complied - See audit report text

Policy Statement 6 - Project Papers are to (a) include an evaluation of the need for audit coverage in light of potential risks, and (b) describe planned contract and project audit coverage by the host government, AID and/or independent public accountants. Project funds should be budgeted for independent audits unless adequate audit coverage by the host country is reasonably assured or audits by third parties are not warranted as, for example, in the case of direct AID contracts or direct placement of participants by AID.

Partially complied - See audit report text

Policy Statement 7 - In lieu of the current negative statement, the project officer is to provide to the controller a statement advising the basis upon which administrative approval is given. AID/W implementing guidelines provided a checklist to be used by project officers when approving vouchers for payment.

Partially complied - See audit report text

Policy Statement 8 - Mission controllers are responsible for providing annual assessments of the Mission voucher approval and voucher examination procedures. Such assessments should indicate the adequacy of supporting documents submitted with contractor invoices and the ability of project officers and authorized certifying officers to relate contractor performance with contractor invoices.

Partially complied - See audit report text

Policy Statement 9 - Mission controllers are to provide annual assessments of the adequacy of the monitoring and invoice examination procedures followed by host country contracting agencies. Such assessments should serve as the basis for reliance on host country performance certificates and voucher reviews.

Partially complied - See audit report text

Policy Statement 10 - USAID controllers are encouraged to use the services of competent public accounting firms to a greater degree in providing accounting and financial management consulting services within the project design as a part of program funding and in auditing host country contracts. In their areas of responsibility, USAID controllers are encouraged to use contract personnel to supplement direct-hire foreign nationals for voucher examination.

Partially complied - See audit report text

Policy Statement 11 - The agency's commodity price analysis function should be strengthened to permit more adequate pre- or post-payment audit of commodity costs.

No action required

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Policy Statement 12 - Where suitable and subject to federal and AID control guidelines, the agency should place greater reliance upon incentive contract approaches, where contractors share in savings or receive extra benefits for timely completion.

No action required

Policy Statement 13 - Host country contracts should include definitive requirements for submission of invoices and supporting documents.

No action required

Policy Statement 14 - Models for use of the Fixed Amount Reimbursement concept for non-construction projects should be developed for consideration.

Complied

Policy Statement 15 - Definitive requirements for arrival accounting should be developed and published for commodity import programs. Assessments of arrival accounting systems should be included in all commodity import program approval documents.

Complied

Policy Statement 16 - The agency will explore resuming use of formal two-step loan agreements given the increased emphasis on private sector participation.

No action required

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SCHEDULE SHOWING ADEQUACY OF COMPLIANCE WITH
PAYMENT VERIFICATION POLICIES
FOR SELECTED PROJECT PAPERS

EXHIBIT 3

	<u>Country & Date of PP or PAAD</u>	<u>Project Title & Project#</u>	<u>Prescribed Financing Format</u>	<u>Controller Concurrence</u>	<u>Less Vulnerable Fin. Method</u>	<u>Host Govt. Commodity Arrival Acctg.Syst.</u>	<u>Host Country Contracting</u>	<u>Evaluation of Audit Need</u>	<u>Adequacy of Audit Funding</u>
1.	KENYA 7/7/86	National Ag. Research #615-0229 (PP)	NO	NO	OK	OK	NO	NO	NO
2.	KENYA 6/18/86	Family Planning Service # 515-0232 (PP)	OK	NO	OK	N/A	NO	OK	NO
3.	MALAWI 7/18/85	Ag. Research #612-02155(PP)	OK	NO	OK	OK	N/A	OK	NO
4.	MALAWI 7/01/86	Reg. Transport Develop. #690-0237(PP)	OK	OK	N/A	OK	YES	NO	NO
5.	RWANDA 8/30/86	Ag. Survey & Policy Analysis #696-0126(PP)	OK	NO	N/A	OK	N/A	NO	OK
6.	MAURITIUS 3/25/86	CIP #642-K-605(PAAD)	NO	OK	N/A	NO	N/A	NO	OK
7.	UGANDA 9/22/86	Rural Economic Recovery #617-0108(PP)	OK	NO	N/A	OK	N/A	OK	OK
8.	MADAGASCAR 6/16/86	Ag. Rehab. Support #697-0101(PP)	OK	NO	OK	NO	N/A	OK	OK

1/ Although controller concurrence did not always appear on facesheet as required under Policy Statement 2, in most cases RFMC did review as part of the Project Paper clearance process.

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UNITED STATES GOVERNMENT

memorandum

May 04, 1987

DATE:
REPLY TO
ATTN OF:

Harold W. Collamer, Director - RFMC

SUBJECT:

Draft Audit Report of the Regional Financial Management Center,
Nairobi Compliance with AID Payment Verification Policy
Statements

TO:

Richard C. Thabet, RIG/A/N

RFMC acknowledges receipt of subject draft Audit Report and in general we concur in substance with the results of the Audit by your office of RFMC's compliance with AID Payment Verification Policy statements. We believe that most of the issues were resolved or clarified during the subject Audit due to close coordination between our offices.

Specific RFMC comments follows:

Page 4: Report states that " To improve RFMC internal control systems, AID issued 16 Payment Verification Policy Statements. "This statement is misleading. The Policy Statements were issued to improve Mission Financial and Administrative Management on a Agency wide basis and not specifically for RFMC.

Page 4: Report states that "lack of full compliance increased mission vulnerability to mismanagement and abuse of project funds". RFMC believes that the conclusion that lack of full compliance leads to increased vulnerability is misleading. RFMC believes that lack of full compliance may or could lead to increased vulnerability under certain circumstances but we are not aware that partial compliance with 10 policy statements did infact result in mismanagement and abuse of funds.

Page 8: Reference is made to REDSO/ESA and Rwanda issuance of a Bank L/Comm without specific justification. RFMC is unaware of any Bank L/Com issued for REDSO Projects or Rwanda. RFMC has reviewed most recent Assessments for REDSO/ESA and Rwanda (Nairobi 48755 and Kigali 05534) and note that neither cable showed amounts against Bank L/Comm. We have attached copies of these cables for your further Review. It is therefore recommended that reference to REDSO/ESA and Rwanda Bank L/Comms be excluded from final report.

Exhibit 3: Controller concurrence - This should be clarified that although Controller clearance did not always appear on facesheet, in most cases RFMC did review as part of the PP clearance process.

With regard to recommendation No. 1, we agree that RFMC should formalize with our staff the responsibilities and actions to better implement the Payment Verification Policy Statements. We would prefer that the recommendation be more specific as to what action RIG would deem appropriate to meet the intention of Recommendation No. 1.

As regards recommendation No. 2, RFMC believes, that since this involves Handbook changes and effects all missions, that this should be addressed in the RIG world-wide audit and not a specific recommendations to RFMC. If it is determined that this recommendation is needed, then we recommend that it be more specific as to what course of action RFMC should take. Would issuance of a RFMC Notice changing Project Officers statement from negative to positive be sufficient?

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