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AUDIT OF
COMMODITY IMPORT PROGRAM IN ZAMBIA

AUDIT REPORT NO. 3-611-88-10
MARCH 31, 1988

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT

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March 31, 1988

MEMORANDUM FOR DIRECTOR, USAID/Zambia, Ted D. Morse
Richard C. Thabet
FROM: RIG/A/Nairobi, Richard C. Thabet
SUBJECT: Audit of Commodity Import Program in Zambia

The Office of the Regional Inspector General for Audit/Nairobi has completed its audit of the USAID/Zambia Commodity Import Program. Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains four recommendations. Recommendation Nos. 1b and 2a are considered closed and require no further action. Recommendation No. 1a is resolved and will not be closed until receipt of properly certified reports. Recommendation No. 2b is unresolved. Please advise me within 30 days of any additional actions taken to implement Recommendation No. 1a, and further information you might want us to consider on Recommendation No. 2b.

I appreciate the cooperation and courtesy extended to my staff during the audit.

EXECUTIVE SUMMARY

During fiscal years 1980 to 1985, USAID/Zambia made six Commodity Import Program agreements with the Government of Zambia. These six agreements consisted of four loans (\$65 million) and two grants (\$25 million) totalling \$90 million. No agreements were signed after 1985.

The purpose of the Commodity Import Programs was to provide foreign exchange needed to import commodities for the Government of Zambia's economic development programs. Under the programs, fertilizer, fertilizer raw materials, equipment, spare parts, and petroleum products were imported into Zambia. The programs also enabled the Government to generate local currency revenues when the imported products were sold to the Zambian public or private sector. Those revenues, although owned by the Government of Zambia, were to be used to finance agriculture sector development activities agreed to by A.I.D. and the Government of Zambia.

The Office of the Regional Inspector General for Audit/Nairobi made a program results and compliance audit of USAID/Zambia's Commodity Import Programs. The audit objectives were to (1) determine if dollar resources were used to procure eligible commodities, (2) determine whether commodities procured were placed in productive use in Zambia as required by A.I.D. regulations, (3) examine USAID/Zambia's controls over the collection and disbursement of local currency revenues, and (4) review USAID/Zambia's involvement in the programming of local currency. The review of internal controls was limited to the finding areas presented in this report. The audit focused on the last three Commodity Import Program agreements for fiscal years 1983, 1984, and 1985 with obligations totalling \$40 million and expenditures of \$39,068,101. The audit covered the period from August 1983 through April 1987.

The audit showed that foreign exchange resources were used to buy eligible commodities and such commodities were being properly utilized for intended purposes. We concluded, therefore, that as regards the first two objectives of this audit, USAID/Zambia successfully managed this program. However, the audit showed that USAID/Zambia did not have controls sufficient to ensure Commodity Import Program local currency revenues were accounted for, collected and disbursed. Finally, the audit showed that USAID/Zambia actively participated in the programming process, however the timeliness of the process needed improvement.

Public Law 480 Title I food sales agreement required that Title I local currency revenues be used to fund self-help activities. However, USAID/Zambia and the Government of Zambia used the revenues to satisfy deposit requirements of Commodity Import Program grant agreements. Unable to reconcile a commingled Special Account, USAID/Zambia officials decided to satisfy required Commodity Import Program revenue deposits with Title I program revenues. In addition to violating Title I agreement provisions, this transaction to offset Commodity Import Program deposits with Title I funds resulted in double counting and the loss of Kwacha 33,285,754 (\$4,160,719) to development activities. Recommendations are made to recover the funds and to improve accounting controls.

Zambia's economy underwent high inflation - about 60 percent during the year (April 1986 - April 1987) preceding this audit. During high inflation, prudent cash management practice dictated careful consideration of the time value of money. Commodity Import Program agreements always specified the time local currency revenues were to be collected and A.I.D. Policy encouraged the timely use of the revenues. Nevertheless, revenue collections were delinquent and agreement on the specific uses of the revenues was not reached until after revenues were collected. Deposits were delinquent because USAID/Zambia and the Government of Zambia did not effectively track deposits, deposits were commingled with other funds, and USAID/Zambia was unable to reconcile the Special Account. Slowness in programming the funds occurred because the Government of Zambia lacked long-term planning capabilities and USAID/Zambia wanted to maintain flexibility over the use of the funds. In addition, USAID/Zambia officials were concerned that Zambia's inflation problem would be exacerbated by spending the proceeds. The effect of the situation was that inflation reduced the value of the revenues available for development activities. At the time of audit, Commodity Import Program revenues totalling Kwacha 95,895,568 (\$11,986,946) had already lost Kwacha 42,480,850 (\$5,355,106) in purchasing power. Recommendations are made to recover certain funds, to establish a separate Special Account, and to improve the collection and programming of funds.

AUDIT OF
COMMODITY IMPORT PROGRAM IN ZAMBIA

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COMMODITY IMPORT PROGRAM IN ZAMBIA

PART I - INTRODUCTION

A. Background

During fiscal years 1980 to 1985, USAID/Zambia made six Commodity Import Program agreements with the Government of Zambia. These six agreements consisted of four loans (\$65 million) and two grants (\$25 million) totalling \$90 million. No agreements were signed after 1985.

The purpose of the Commodity Import Programs was to provide foreign exchange needed to import commodities for the Government of Zambia's economic development programs. Under the programs fertilizer, fertilizer raw materials, equipment, spare parts, and petroleum products were imported into Zambia. The programs also enabled the Government to generate local currency revenues when the imported products were sold to the Zambia public or private sector. Those revenues although owned by the Government of Zambia, were to be used to finance agriculture sector development activities agreed to by A.I.D. and the Government of Zambia.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Nairobi made a program results and compliance audit of USAID/Zambia's Commodity Import Programs. The audit objectives were to (1) determine if dollar resources were used to procure eligible commodities, (2) determine whether commodities procured were placed in productive use in Zambia as required by A.I.D. regulations, (3) examine USAID/Zambia's controls over the collection and disbursement of local currency revenues, and (4) review USAID/Zambia's involvement in the programming of local currency. The review of internal controls was limited to the finding areas presented in this report. The audit focused on the last three Commodity Import Program agreements for fiscal years 1983, 1984, and 1985 with obligations totalling \$40 million and expenditures of \$39,068,101. The audit covered the period from August 1983 through April 1987.

The audit was made during April and May 1987 in Lusaka, Zambia. Commodity Import Program agreements were reviewed. Selected USAID/Zambia and Government of Zambia records applicable to those agreements were examined. Interviews were held with responsible USAID/Zambia and Government of Zambia officials. Visits were made to two Government of Zambia

parastatal firms and three private companies to examine the end-use of imported commodities. A review was also made of USAID/Zambia's internal controls over the collection and disbursement of local currency, and a judgmental sampling of transactions was performed. The audit was made in accordance with generally accepted government auditing standards.

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PART II -- RESULTS OF AUDIT

The audit showed that foreign exchange resources were used to buy eligible commodities and such commodities were being properly utilized for intended purposes. We concluded, therefore, that as regards the first two objectives of this audit, USAID/Zambia successfully managed this program. However, the audit showed that USAID/Zambia did not have controls sufficient to ensure Commodity Import Program local currency revenues were effectively accounted for, collected and disbursed. Finally, the audit showed that USAID/Zambia actively participated in the programming process, however the timeliness of the process needed improvement.

Inadequate systems and accounting controls for monitoring the collection and disbursement of Commodity Import Program local currency proceeds contributed to the improper use of Title I local currency revenues to offset revenues due under the Commodity Import Program. In addition, the timing of the programming process, compounded by delays in collecting revenues, contributed to a significant erosion in the purchasing power of the revenues.

To correct these situations, the report contains recommendations to improve accountability over collections and to improve the programming process.

A. Findings and Recommendations

1. Title I Revenues Used To Offset Deposits Required From Commodity Import Programs

Public Law 480 Title I food sales agreements required that Title I local currency revenues be used to fund self-help activities. However, USAID/Zambia and the Government of Zambia used Title I revenues to satisfy deposit requirements of Commodity Import Program grant agreements. Unable to reconcile a commingled Special Account, USAID/Zambia officials decided to satisfy required Commodity Import Program revenue deposits with Title I program revenues. In addition to violating Title I agreement provisions, this transaction to offset Commodity Import Program deposits with the Title I funds resulted in double counting and the loss of Kwacha 33,285,754 (\$4,160,719)^{1/} to development activities.

Recommendation No. 1

We recommend that USAID/Zambia officials:

- a. develop a Memorandum of Understanding with the Government of Zambia whereby the Government of Zambia will reimburse the Title I program Kwacha 33,285,754 to fund development related self-help measures identified in the Title I agreement; and
- b. include in any future Commodity Import Program grant agreements, a provision that Commodity Import Program local currency revenues be deposited into a separate Special Account limited to Commodity Import Program revenues.

Discussion

USAID/Zambia signed two Commodity Import Program grant agreements (in 1984 and 1985) with the Government of Zambia, as well as a 1986 Title I sales agreement, all which generated local currency revenues. Under the Commodity Import Program

^{1/} The Kwacha local currency was actually generated during a period when the exchange rate floated between Kwacha 2.07 to \$1.00 and Kwacha 14.33 to \$1.00. However, in April, 1987 the Government of Zambia unilaterally fixed the exchange rate of Kwacha 8.00 to \$1.00, which is the basis for the dollar amounts shown here and throughout this report.

agreements, the local currency revenues generated by those agreements were to fund development activities agreed to by USAID/Zambia and the Government of Zambia. Under the Title I sales agreement, the generated local currency revenues were to fund specific self-help measures identified in the agreement. Unlike the Title I agreement, the Commodity Import Program agreements required that the resulting local currency revenues be deposited into a Special Account, as required by legislation, to facilitate tracking the receipt and use of the monies. Despite these provisions, Title I revenues were used to offset revenues due from the Commodity Import Program - a violation of the provisions of the Title I agreement.

As required by the Commodity Import Program agreement, a Special Account (No. 846), established in 1983 to record PL 480 Title II transactions was used as the depository for the resulting local currency revenues. Rather than open a new Special Account to record only Commodity Import Program transactions, the Government of Zambia continued to deposit revenues from the Commodity Import Program, the Title I sales program and other programs into the same Special Account thus commingling Commodity Import Program revenues with revenues from other sources. This commingling was improper since the legislative requirement for a Special Account was intended to preclude commingling (see Exhibit 1).

Beginning in late 1985, USAID/Zambia attempted to reconcile the funds generated with funds deposited to the Special Account. The reconciliation was complicated by the commingling of revenues, unauthorized withdrawal of funds, deposits from unidentified sources, Government of Zambia failure to submit required reports, and untimely bank statements.

The attempts at reconciliation continued until April 27, 1987. At that time USAID/Zambia officials, still unable to reconcile the account, forwarded a proposal to the Government of Zambia which they believed would "regularize the status of Account No. 846." Under USAID/Zambia's proposal, "inappropriate deposits" (deposits from the Title I program, other local currency programs, and from unknown sources) totalling Kwacha 33,285,754 (\$4,160,719) would be used to offset amounts owed to the Special Account from the Commodity Import Program and other A.I.D. financed local currency generating programs. For example, Kwacha 20.7 million (\$2,587,500) was used to offset a debt owed by Nitrogen Chemical of Zambia. Nitrogen Chemical, a parastatal had imported fertilizer under the 1984 Commodity Import Programs and never paid.

USAID/Zambia officials told the auditors that it was proper to use the Title I local currency revenues to offset the Nitrogen Chemical debt. They stated that the Government of Zambia should not have deposited these funds into the Special Account, but since the funds were there, they could be used to offset this liability.

The position taken by USAID/Zambia officials was unacceptable for two reasons. First, the Title I agreement, under which those local currency revenues were generated, required that such revenues be used to finance the self-help provisions specified in the agreement. Second, authorizing their use to pay liabilities incurred under another A.I.D. program resulted in double counting and reduced the amount available to finance Title I self-help measures. In this case, the amount available for such development activities was reduced by Kwacha 33,285,754 (\$4,160,719).

Management Comments

USAID/Zambia officials disagreed with the finding. USAID/Zambia officials stated that the negotiated solution to offset Commodity Import Program revenues with Title I revenues was appropriate. The comments also reflected the position that the Government of Zambia had already used their own funds to fully fund the self-help measures called for by the Title I agreement and suggested this recommendation be dropped from the final audit report.

Office of Inspector General Comments

We still maintain the position that the negotiated offset method used by USAID/Zambia and the Government of Zambia constituted a violation of the Title I agreement provisions. Concerning the recommendation to recover the amount necessary to fully fund required Title I self-help measures, we note that USAID/Zambia comments indicate that the Government of Zambia has subsequently fully funded those measures from their own resources. Accordingly, we consider this recommendation resolved and upon receipt of properly certified reports to that effect we will close the recommendation.

Management Comments

USAID/Zambia officials commented that they did not agree that the recommendation to establish a separate Special Account for Commodity Import Program proceeds would necessarily result in improved management or accountability for local currency; however they agreed to conform to the recommendation.

Office of Inspector General Comments

We consider this recommendation resolved and based on USAID/Zambia comments the recommendation is closed upon issuance of the report.

2. USAID/Zambia Needs To Ensure That Local Currency Revenues Are Collected and Programmed Sooner

Zambia's economy underwent high inflation - about 60 percent during the year (April 1986 - April 1987) preceding this audit. During high inflation, prudent cash management practice dictated careful consideration of the time value of money. Commodity Import Program agreements always specified the time local currency revenues were to be collected and A.I.D. policy encouraged the timely use of the revenues. Nevertheless, revenue collections were delinquent and agreement on the specific uses of the revenues was not reached until after revenues were collected. Deposits were delinquent because USAID/Zambia and the Government of Zambia did not effectively track deposits, deposits were commingled with other funds, and USAID/Zambia was unable to reconcile the Special Account. Slowness in programming the funds occurred because the Government of Zambia lacked long-term planning capabilities and USAID/Zambia wanted to maintain flexibility over the use of the funds. In addition, Mission officials were concerned that Zambia's inflation problem would be exacerbated by spending the proceeds. The effect of the situation was that inflation reduced the value of the revenues available for development activities. At the time of audit, Commodity Import Program revenues totalling Kwacha 95,895,568 (\$11,986,946) had already lost Kwacha 42,480,850 (\$5,355,106) in purchasing power.

Recommendation No. 2

We recommend that USAID/Zambia officials:

- a. develop procedures for ensuring that deposits are made timely, in accordance with agreement provisions. Such procedures should include a provision that debtors present USAID/Zambia officials with a copy of the deposit slip since delays in receiving bank statements hindered quick follow-up on verifying deposits; and future agreements should include a provision that delinquent debtors be assessed penalties and interest on late payments, which would encourage timely deposits.
- b. jointly develop with Government of Zambia officials programming procedures which result in the programming of local currency revenues prior to actual receipt, and have the effect of reducing the time between receipt and disbursement.

Discussion

Zambia experienced a 60 percent inflation rate. Prudent cash management principles dictated close attention to the collection and expenditure of funds during such an inflationary period. The longer funds remain unexpended during an inflationary period, the more the purchasing power of the funds decreased - the lost purchasing power became a wasted resource.

The Commodity Import Program grant agreements between USAID/Zambia and the Government of Zambia contained provisions about when local currency revenues were to be deposited. Under the 1984 agreement, Section 5.7.(b) required that "... deposits to the Special Account for agricultural spare parts shall become due and payable at the time request is made for issuance of Letters of Credit or Direct Letters of Commitment. Deposits to the Special Account for fertilizer and fertilizer raw materials shall be due and payable in quarterly equal installments, the first installment to be due eighteen months from the date of issuance of the first Direct Letter of Commitment and the final installment to be due twelve months later." Under the 1985 agreement, Section 5.7.(b) was revised to read that "... deposits to the Special Account shall become due and payable at the time request is made for issuance of Letters of Credit or Direct Letters of Commitment." The agreements contained no provisions for charging interest and penalties to delinquent debtors.

A.I.D. Policy Determination No. 5, as amended in 1984, required that local currency revenues from Commodity Import Programs be spent as closely as possible to the time the commodities were received. The purpose of the policy was to minimize the inflationary or deflationary effects from delays in spending revenues.

As of April 22, 1987, deposits to the Special Account attributed to the 1984 and 1985 Commodity Import Program totalled Kwacha 119,069,672 (\$14,883,709)^{2/} which constituted

^{2/} The 1984 and 1985 Commodity Import Program grant agreements actually provided commodities valued at about \$25 million to the Government of Zambia. The deposit requirements totalling Kwacha 119,069,692 were based on exchange rates ranging from Kwacha 2.07 to \$1.00 up to Kwacha 14.33 to \$1.00 during the period covered by the grants. As noted previously, in April 1987, the Government of Zambia unilaterally fixed an exchange rate of Kwacha 8.00 to \$1.00 which is the basis for the dollar amount shown here.

full collection of Commodity Import Program local currency revenues as reconciled in USAID/Zambia's April 27, 1987 proposal to the Government of Zambia. Of this amount, Kwacha 23,174,104 (\$2,896,763) had been disbursed for agreed to development activities, leaving a balance of Kwacha 95,895,567 (\$11,986,946).

An analysis of the dates local currency revenues were due to be deposited and the dates deposits were actually made revealed that most of the funds deposited into the Special Account were delinquent deposits. Some funds were deposited as much as 13 months late even though USAID/Zambia officials were attempting to reconcile since late 1985. For example, on April 22, 1987, Kwacha 118,518,709 (\$14,814,838) was deposited by Zimco Ltd., a parastatal, to cover delinquent payments under the 1985 Commodity Import Program and an A.I.D. cash transfer grant program.

Our analysis of deposits also showed that as of April 22, 1987, the purchasing power of the Kwacha deposits on hand, totalling Kwacha 95,895,567 (\$11,986,946), had declined the equivalent of Kwacha 42,840,850 (\$5,355,106). This purchasing power loss was attributable to the 60 percent inflation rate occurring in Zambia between the time deposits were due and April 22, 1987.

The Kwacha 42,840,850 (\$5,355,106) purchasing power loss could have been minimized if USAID/Zambia and the Government of Zambia had implemented a system to monitor and ensure timely deposits and then done more timely programming of the use of local currency revenues. The audit showed however that during this period, USAID/Zambia was unable to reconcile deposits to the Special Account and even though USAID/Zambia had continuing dialogue on programming with the Government of Zambia, agreement on specific use awaited the receipt of deposits. Thus, the expenditure of funds was further delayed.

Regarding USAID/Zambia's practice of not doing earlier programming of funds use, USAID/Zambia officials stated that several factors were involved. Those officials told us the Government of Zambia did not have the capability for doing the long-term planning that would be required. They have however initiated actions to improve this planning capability. The officials also stated that they preferred the flexibility of having unprogrammed funds available to induce Government of Zambia officials to take certain actions. USAID/Zambia officials also stated that they were opposed to programming the use of money merely to beat the rate of inflation and they were concerned about the effect on Zambia's inflation which would result from spending the revenues.

RIG/A/N believes that USAID/Zambia's comments regarding flexibility, programming merely to beat inflation, and concerns about the effect on inflation have validity. RIG/A/N does not suggest money be expended solely to beat inflation and recognizes the potential effect spending local currency proceeds could have on inflation. However, RIG/A/N believes advance planning on the use of funds before receipt is a common and appropriate practice to minimize the loss of purchasing power due to inflation.

Management Comments

USAID/Zambia officials agreed with our recommendation to develop procedures for ensuring that deposits are made timely, in accordance with agreement provisions. Their response also presented the systems and procedures to be adopted.

Office of Inspector General Comments

We closely reviewed the procedures to be incorporated in future agreements and believe they will resolve problems encountered in earlier programs. Accordingly, this recommendation is considered resolved and closed upon issuance of the report based on USAID/Zambia expressed commitment to incorporate such procedures in future agreements.

Management Comments

USAID/Zambia officials in general disagreed with the recommendation to develop programming procedures which result in the programming of local currency revenues prior to actual receipt and have the effect of reducing the time between receipt and disbursement. Concerning this "pre-programming," the officials stated that programming all funds "when an agreement is signed is actually counterproductive." The response also reiterated the position presented in the report.

Office of Inspector General Comments

We do not disagree with USAID/Zambia's position that it could be counterproductive to pre-program all the funds at the time agreements are signed - usually one to two years prior to actual receipt of the funds. This position was not taken by us in the report and, as such, is an inappropriate argument. However, we continue to believe that funds managers should, prior to actually receiving the funds, begin doing the analytical work and formulating specific plans for using the funds - especially in periods of high inflation. Our recommendation is merely that USAID/Zambia develop, document, and implement procedures to that effect.

B. Compliance and Internal Control

Compliance

The audit disclosed that Commodity Import Program local currency revenues had been improperly offset with local currency revenues generated by Public Law 480 Title I sales (See Finding No. 1). Recipients of the Commodity Import Program did not make timely deposits to the Special Account (See Finding No. 2).

The audit also disclosed that USAID/Zambia did not require the Government of Zambia to deposit Commodity Import Program local currency revenues in a Special Account separate from other local currency revenues. Rather, Commodity Import Program local currency revenues were commingled with revenues from other programs such as Title I sales and cash transfers. Based on a legal opinion from the A.I.D.'s Inspector General Legal Counsel -we determined that a separate Special Account was required for Commodity Import Program local currency revenues. A recommendation was made to establish such an account (See Finding No. 1).

Nothing else came to our attention that would indicate tested and untested items did not conform to applicable laws, regulations and agreements.

Internal Controls

USAID/Zambia and the Government of Zambia did not have adequate accounting systems to ensure that local currency revenue deposits were made as required by Commodity Import Program agreements. This resulted in an inability to reconcile deposits to the Special Account (see Finding No. 1). The review of internal controls was limited to the finding areas presented in this report.

AUDIT OF
COMMODITY IMPORT PROGRAM IN ZAMBIA

EXHIBIT AND APPENDICES

ACTION: AID-3 INFO: ECON RLO

VECTCNA0985

12-PPR-22

CO: 27:39

PP BUENNE

CY: 56405

DB BURHC #4369 243065E

OPPG: AID

ZNR UUUUH ZZE

TST: AID

P 120652Z FEB 82

ADD:

FM SECSTATE WASHDC

TO AMEMBASSY NAIROBI PRIORITY 6139

BT

UNCLAS STATE 044369

AIDAC, FOR RIO/A/W TRABET FROM IG/LC PERKINS

E.O. 12356: N/A

SUBJECT: SPECIAL ACCOUNT REQUIREMENTS FOR CIF LOCAL CURRENCY

REF: NAIROBI 24035

1. REFTEL ON SPECIAL ACCOUNT FOR CIF PROCEEDS REQUIRED BY SECTION 609(A) OF THE FIA OF 1961, AS AMENDED. COMINGLING WITH LOCAL CURRENCY ACCRUED FROM OTHER PROGRAMS E.G., PL 480 OR ISF CASE TRANSFERS IS NOT CONSISTENT WITH STATUTORY REQUIREMENT OF SEPARATE/SPECIAL ACCOUNT. CIF LOCAL CURRENCY UTILIZATION PERMITTED UNDER SECTION 609 CAN NOT BE TRACED IF FUNDS ARE COMINGLED. PLEASE ADVISE IF ADDITIONAL INFORMATION REQUIRED. SEULTZ

BT

#6360

NNNN

UNCLASSIFIED

STATE 044369

ACTION: AID-3 INFO: ECON RIO

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 OO RUEHNR
 DE RUEHLS #1312/01 0821529
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 O 221513Z MAR 88
 FM AMEMBASSY LUSAKA
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 UNCLAS SECTION 01 OF 07 LUSAKA 01312

22-MAR-88 TOR: 13:37
 CN: 04582
 CHRG: AID
 DIST: AID
 ADD:

FOR RIG/A

E.O. 12356: N/A
 SUBJECT: USAID/ZAMBIA COMMENTS ON DRAFT AUDIT REPORT
 NO 3-611-88-XXX (CIP)

REF: 87 LUSAKA 4281

1. USAID APPRECIATES THE OPPORTUNITY TO COMMENT ON THE DRAFT AUDIT REPORT. WE ARE PARTICULARLY PLEASED THAT OUR EARLIER COMMENTS ON REFTEL HAVE BEEN TAKEN INTO CONSIDERATION BY RIG IN: (1) NARROWING THE FOCUS OF RECOMMENDATIONS TO THOSE AREAS ORIGINALLY IDENTIFIED IN THE REPORT AUDIT FINDINGS (RAF); AND (2) MAKING MENTION, ALBEIT ONLY ONE SENTENCE, THAT "THE AUDIT SHOWED THAT FOREIGN EXCHANGE RESOURCES WERE USED TO BUY ELIGIBLE COMMODITIES AND SUCH COMMODITIES WERE BEING PROPERLY UTILIZED FOR INTENDED PURPOSES." WE BELIEVE THIS STATEMENT, THOUGH BRIEF, IS VERY SIGNIFICANT SINCE THE AUDIT COVERED SIX CIPS, FINANCING USDOLS 92 MILLION OF EQUIPMENT, SPARES, FERTILIZER, FERTILIZER RAW MATERIALS, ANIMAL FEED AND PETROLEUM IN A DIFFICULT LDC SETTING. THE AUDIT DID NOT FIND THE TYPES OF DIFFICULTIES WHICH HAVE PLAGUED ESP PROGRAMS ELSEWHERE, SUCH AS PROCUREMENT PROBLEMS, A LACK OF FINANCIAL ACCOUNTABILITY OF DOLLARS PROVIDED TO FINANCE IMPORTS, FAILURE TO OBSERVE A.I.D. REGULATION PROCEDURES, PROGRAMMATIC OR ADMINISTRATIVE INEFFICIENCIES OR ANY TYPE OF CORRUPTION. WE BELIEVE THE OBVIOUS IMPLICATION IS THAT THESE TYPES OF PROBLEMS WERE AVERTED BY GOOD MANAGEMENT OF THE ZAMBIA CIPS.

PART ONE OF OUR COMMENTS DEALS WITH FACTUAL OR LOGICAL ERRORS CONTAINED IN THE BODY OF THE REPORT. PART TWO WILL PROVIDE OUR COMMENTS SPECIFIC TO THE REPORT'S RECOMMENDATIONS.

 PART ONE

2. EXECUTIVE SUMMARY PAGE III: THE DRAFT REPORT STATES: "PUBLIC LAW 480 TITLE I FOOD SALES AGREEMENTS REQUIRED THAT TITLE I LOCAL CURRENCY REVENUES BE USED TO FUND SELF-HELP ACTIVITIES."

COMMENT: IN FACT, THE AUTHORIZED USE OF LOCAL CURRENCY IS CONSIDERABLY BROADER. THE 1985 ZAMBIA-PL 480 TITLE I AGREEMENT STATES: "THE PROCEEDS... WILL BE USED FOR FINANCING THE SELF-HELP MEASURES SET FORTH IN THE AGREEMENT, AND FOR DEVELOPMENT IN THE AGRICULTURAL AND RURAL SECTORS IN A MANNER DESIGNED TO INCREASE THE ACCESS OF THE POOR IN ZAMBIA TO AN ADEQUATE NUTRITIOUS AND STABLE FOOD SUPPLY." THIS SAME ERROR ALSO APPEARS IN A NUMBER OF OTHER PLACES IN THE TEXT.

3. EXECUTIVE SUMMARY PAGE III: THE DRAFT REPORT STATES: "UNABLE TO RECONCILE A COMMINGLED SPECIAL ACCOUNT, USAID/ZAMBIA DECIDED TO SATISFY REQUIRED COMMODITY IMPORT PROGRAM REVENUE DEPOSITS WITH TITLE I PROGRAM REVENUES."

COMMENT: THE FACT THAT THE ACCOUNT WAS "COMMINGLED" IS IRRELEVANT. FURTHER, TO POSIT THAT USAID/ZAMBIA WAS UNABLE TO RECONCILE A "COMMINGLED" SPECIAL ACCOUNT IS IRRELEVANT AND MISLEADING, AND ULTIMATELY INCORRECT.

4. PAGE 7: THE DRAFT REPORT STATES: "RATHER THAN RESTRICT THE SPECIAL ACCOUNT TO COMMODITY IMPORT PROGRAM TRANSACTIONS, USAID/ZAMBIA ALLOWED THE GOVERNMENT OF ZAMBIA TO DEPOSIT REVENUES FROM THE TITLE I SALES PROGRAM AND OTHER PROGRAMS...."

CLARIFICATION: ACCOUNT NO 846 WAS ORIGINALLY ESTABLISHED IN 1983 TO CONTAIN TITLE II REFLWS. THE CIP REFLWS WERE DEPOSITED TO THE ACCOUNT SUBSEQUENTLY. THE STATEMENT ABOVE IS MISLEADING, AS THERE WAS NEVER A POSSIBILITY OF "RESTRICTING" THE ACCOUNT TO CIP DEPOSITS, BECAUSE TITLE II REFLWS WERE ALRFADY IN THE ACCOUNT. FURTHERMORE, THE IMPLICATION OF THE ABOVE STATEMENT (USAID/ZAMBIA

ALLOWED...) IS MISLEADING, INSOFAR AS IT IMPLIES A CONSIDERED AND DELIBERATE ACT. OBVIOUSLY, USAID/ZAMBIA HAS NO IMMEDIATE CONTROL OVER ERRONEOUS DEPOSITS TO THE SPECIAL ACCOUNT. WE NEVER ALLOWED THE TITLE I IMPORTERS TO DEPOSIT FUNDS TO ACCOUNT NO. 846 (AT LEAST THROUGH THE 1985 PROGRAM); INDEED, WE INSTRUCTED THEM TO DEPOSIT THE REFLOWS IN THE GRZ GENERAL REVENUE ACCOUNT. (NOTE: STARTING WITH THE 1986 PROGRAM, THE MISSION SWITCHED FROM ATTRIBUTION TO PROGRAMMING REFLOWS AND CONSEQUENTLY INSTRUCTED IMPORTERS TO MAKE DEPOSITS INTO THE SPECIAL ACCOUNT.)

5. PAGE 8: THE DRAFT REPORT STATES: "...STILL UNABLE TO RECONCILE THE ACCOUNT...."

COMMENT: USAID QUESTIONS WHAT RIG MEANS BY "RECONCILE THE ACCOUNT" IN THIS INSTANCE. WE HAD DETERMINED THE DEPOSIT REQUIREMENT FOR THE CIP PROGRAM, AND KNEW WHAT DEPOSITS HAD BEEN MADE, AND BY EXTENSION, THE SHORTFALL IN DEPOSITS. WE KNEW WHAT TITLE I (ERRONEOUS) DEPOSITS HAD BEEN MADE, HAD DETERMINED THAT THE DEPOSIT REQUIREMENT WAS ZERO, AND THAT THE EXTANT DEPOSITS WERE EXTRANEOUS. THE ACCOUNT, THUS, WOULD SEEM TO HAVE BEEN RECONCILED, AND THAT RECONCILIATION INDICATED THAT THERE WAS A SHORTFALL OF CIP DEPOSITS, AND A COLLECTION OF (ERRONEOUS) TITLE I DEPOSITS.

6. PAGE 10: THE DRAFT REPORT STATES: "DEPOSITS WERE DELINQUENT BECAUSE...DEPOSITS WERE COMMINGLED WITH OTHER FUNDS."

COMMENT: THE TWO PHENOMENA ARE CAUSALLY INDEPENDENT.

7. REQUEST THAT THE DRAFT REPORT BE MODIFIED TO CORRECT THE ERRORS, IN ACCORDANCE WITH THE ABOVE.

PART TWO

8. RECOMMENDATION NO. 1 (A): WE ARE PLEASED THAT OUR COMMENTS (REFTEL), AS WELL AS EXTENDED DISCUSSIONS WITH RIG/A STAFF, HAVE RESULTED IN SOME MODIFICATION OF THIS RECOMMENDATION FROM ITS EARLIER FORM. HOWEVER, WE REMAIN IN DISAGREEMENT WITH THE RECOMMENDATION. ONCE AGAIN, BRIEF BACKGROUND INFORMATION WILL EXPLAIN THE BUDGETARY ATTRIBUTION PROCESS INVOLVED WITH THE PL 480 PROGRAM. TITLE I REFLOWS (PRIOR TO 1986) WERE ATTRIBUTED TO THE GRZ DEVELOPMENT BUDGET. UNDER OUR SCENARIO, THE ATTRIBUTION PROCESS IS (DUE TO THE FUNGIBILITY OF RESOURCES) TANTAMOUNT TO CONCLUDING THAT A CERTAIN PORTION OF DEVELOPMENT BUDGET EXPENDITURES IN FACT HAVE BEEN FUNDED AS A RESULT OF OUR PL 480 PROGRAM (I.E., BY TITLE I SALES PROCEEDS TO BE PLACED IN THE GRZ GENERAL REVENUE ACCOUNT). THIS CONCLUSION IS BASED ON OFFICIAL DOCUMENTATION POSITING SUCH. AT

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THIS POINT, IT IS USEFUL TO EXAMINE EXACTLY WHAT HAPPENED REGARDING SELF HELP MEASURES. IN COMPLETE COMPLIANCE WITH PROVISIONS OF TITLE I AGREEMENTS, THE GRZ HAS ALREADY SATISFACTORILY FUNDED ALL REQUIRED SELF HELP MEASURES FROM THE GRZ GENERAL REVENUE ACCOUNT. THIS WAS EVIDENCED BY MINISTRY OF FINANCE LETTERS TO USAID OUTLINING THEIR ATTRIBUTION OF TITLE I FUNDS. THUS, THE BUDGET ATTRIBUTION PROCESS AND THE DEVELOPMENT ACTIVITIES REQUIRED BY AID HAVE ALREADY BEEN COMPLETED. IT IS TOTALLY INCORRECT AT THIS POINT FOR RIG TO RECOMMEND THAT THE GRZ REIMBURSE THE TITLE I KWACHA 33,285,754.57 TO FUND SELF HELP MEASURES (AND OTHER ALLOWED PURPOSES) IDENTIFIED IN THE TITLE I AGREEMENT BECAUSE THE GRZ HAS ALREADY FUNDED THEM. AT THIS POINT, DRAWING KWACHA OUT OF THE SPECIAL ACCOUNT AND THEN DEPOSITING THOSE FUNDS IN THE GENERAL REVENUE FUND FOR PL 480 AGREED PURPOSES WOULD MEAN DOUBLE COUNTING OF SELF HELP MEASURES, I.E., THE GRZ WOULD BE SPENDING K66 MILLION INSTEAD OF K33 MILLION ON AGREED PURPOSES. WHILE SOME TITLE I MONEY ERRONEOUSLY WENT INTO THE SPECIAL ACCOUNT, THE GRZ WAS STILL ABLE TO FINANCE SELF HELP MEASURES FROM OTHER SOURCES OF REVENUE, I.E., THE FUNGIBILITY OF MONEY ARGUMENT. THE ATTRIBUTION PROCESS, BY DEFINITION, GIVES THE GRZ FLEXIBILITY IN THEIR NORMAL DAY-TO-DAY OPERATIONS OF TRANSFERRING FUNDS IN MEETING BOTH PL480 AND CIP OBLIGATIONS; THEY

ACCOMPLISHED THIS. UNDER ATTRIBUTION, WE ONLY LOOK FOR SELF HELP RESULTS AND WE GOT THEM.

UNDER CIP PROGRAMMING OF COUNTERPART, WE REQUIRE LOCAL CURRENCY DEPOSITS EQUIVALENT TO THE VALUE OF THE SALE OR IMPORTATION OF CIP-FINANCED COMMODITIES. ALL THE LOCAL CURRENCY WAS DEPOSITED. THUS, WE STILL DISAGREE CATEGORICALLY WITH RIG'S INTERPRETATION OF THE RELEVANT CIP GRANT AGREEMENT, AND THIS RECOMMENDATION AND MUST RESTATE OUR EARLIER POSITION IN REFTTEL. SECTION 5.7, USE OF LOCAL CURRENCY OF THE FY 1984 CIP STATES QUOTE: (A) THE GRANTEE WILL ESTABLISH AND MAINTAIN A SPECIAL ACCOUNT IN THE BANK OF ZAMBIA AND DEPOSIT THEREIN CURRENCY OF THE GOVERNMENT OF THE REPUBLIC OF ZAMBIA IN AMOUNTS EQUAL TO PROCEEDS ACCRUING TO THE GRANTEE OR ANY AUTHORIZED AGENCY THEREOF AS A RESULT OF THE SALE OR IMPORTATION OF ELIGIBLE ITEMS. UNQUOTE. N.B. THE GRANTEE (OR MOF ON BEHALF OF THE GRZ) HAS THE OBLIGATION TO ESTABLISH THE ACCOUNT AND INSURE THAT DEPOSITS ARE UP TO DATE. ONCE AGAIN, THE GRZ BROUGHT REQUIRED DEPOSITS UP TO DATE.

TO SUMMARIZE THE SOLUTION, THE GRANTEE, MOF, MADE THE SPECIAL ACCOUNT DEPOSIT AS REQUIRED BY THE PROGRAM AGREEMENT. THE NEGOTIATED SOLUTION INVOLVED CREDITING THE SPECIAL ACCOUNT WITH DEPOSITS BY RECIPIENTS OF PL 480 ASSISTANCE WHICH WERE DUE TO THE GRZ (GENERAL REVENUE FUND), BUT HAD BEEN INADVERTENTLY DEPOSITED INSTEAD INTO SPECIAL ACCOUNT 846. WHEN WE DISCUSSED THESE DEPOSITS, THE MINISTRY OF FINANCE CHOSE THE ALTERNATIVE OF LEAVING THEM IN ACCOUNT 846 AS A CREDIT AGAINST THE GRANTEE'S OBLIGATION TO DEPOSIT K33.28 MILLION TO COVER THE VALUE OF RAW MATERIALS IMPORTED UNDER THE 1984 CIP. TO COMPLETELY SETTLE THE GRANTEE'S DEBT, THE MOF DEPOSITED AN ADDITIONAL K3.4 MILLION. THIS NEGOTIATED SETTLEMENT BETWEEN THE MOF (ON BEHALF OF THE GRANTEE) AND USAID CLEARED THE TOTAL OBLIGATION OF THE GRANTEE TO DEPOSIT KWACHA EQUAL TO THE PROCEEDS OF IMPORTATION UNDER THE FY 1984 CIP. THE MOF AND NCZ (A CIP IMPORTER OF FERTILIZER RAW MATERIALS WHICH DID NOT MAKE A SPECIAL ACCOUNT DEPOSIT) ARE CURRENTLY FINALIZING A LOAN AGREEMENT TO TAKE CARE OF NCZ'S INTER-AGENCY DEBT TO THE MINISTRY OF FINANCE.

AS WE SEE IT, THE GRANTEE (OR GRZ) HAS SETTLED ITS OBLIGATION TO DEPOSIT THE CORRECT AMOUNT OF COUNTERPART INTO THE SPECIAL ACCOUNT. ON BEHALF OF THE GRZ, THE MOF SQUARED THE ACCOUNT BY: (1) DISCRETIONARY USE OF PL 480 DEPOSITS IN ACCOUNT 846 INSTEAD OF THE GENERAL REVENUE FUND AND (2) "TOPPING UP" THE DIFFERENCE WITH A K3.4 MILLION DEPOSIT. THE CURRENT ARRANGEMENTS TO SETTLE THE ACCOUNT BETWEEN THE MOF AND ANY ORGANIZATION WHICH MAY (OR MAY NOT) HAVE DEPOSITED TOO MUCH (OR TOO LITTLE) ARE PART OF

THE NORMAL DAY-TO-DAY OPERATIONS OF THE GRZ. AGAIN, THE GRANTEE HAS FULFILLED ITS OBLIGATION AND MADE THE COUNTERPART DEPOSITS WITH GRZ OWNED LOCAL CURRENCY; THE CONCERN OF RIG THAT THE GRZ SHOULD REIMBURSE PL 480 SELF HELP MEASURES IS INCORRECT AND TOTALLY COUNTERPRODUCTIVE BECAUSE THE SELF HELP MEASURES IN QUESTION HAVE BEEN ACCOMPLISHED, USING GRZ FUNDS APPLIED TOWARDS THOSE MUTUALLY AGREED ITEMS INCLUDED IN THE PL 480 AGREEMENTS. THEY ARE HISTORY BECAUSE THE GRZ ALREADY FUNDED THEM. WE SUGGEST THAT THIS RECOMMENDATION BE DROPPED FROM THE FINAL AUDIT REPORT.

9. RECOMMENDATION 1 (B): WE BELIEVE, AS DISCUSSED AT LENGTH WITH RIG/A/NAIROBI AUDITORS AND IN REFTTEL, THAT THE ESTABLISHMENT IN ZAMBIA OF ADDITIONAL COUNTERPART FUND ACCOUNTS IS, AT WORST,

COUNTERPRODUCTIVE, AND AT BEST, OF VERY MARGINAL UTILITY. OUR REASONS FOR THIS ARE STATED IN REFTTEL BUT ARE REPEATED HERE FOR THE RECORD. WE STILL BELIEVE THAT THE CURRENT MISSION ACCOUNTING PROCEDURES ARE ADEQUATE TO TRACK BOTH THE DEPOSITS AND THE WITHDRAWALS FROM SPECIAL ACCOUNT NO. 846 OF COUNTERPART FUNDS FROM WHATEVER SOURCE. WE REMAIN CONVINCED THAT SETTING UP MULTIPLE ACCOUNTS WOULD BE OF MARGINAL VALUE AS A MANAGERIAL TOOL; IN FACT, THIS WOULD CREATE MULTIPLE MANAGEMENT, ACCOUNTING AND TIME/USE PROBLEMS FOR USAID AND MORE IMPORTANTLY FOR THE GRZ. BY DESIGN, PROGRAMMING OBJECTIVES FOR ALL AGREEMENTS ARE THE SAME. REGARDLESS OF SOURCE, FUNDS ARE PROGRAMMED INTO AG SECTOR ACTIVITIES ON A FIRST-IN, FIRST OUT BASIS, AND MATCHED WITH THE AGREEMENT THAT GENERATED THE COUNTERPART. MULTIPLE ACCOUNTING WILL INCREASE THE USAID/ZAMBIA WORKLOAD, AND SIGNIFICANTLY INCREASE THE ACCOUNTING AND PAPERWORK WORKLOADS OF THE ALREADY OVER-BURDENED GRZ MINISTRY OF FINANCE AND BANK OF ZAMBIA. IN ADDITION, USAID DOES NOT LOOK FORWARD TO ATTEMPTING TO RESOLVE THE INEVITABLE PROBLEMS OF MOVING A DEPOSIT FROM THE WRONG SPECIAL ACCOUNT TO THE CORRECT SPECIAL ACCOUNT.

EQUALLY IMPORTANTLY, WE ARE CONCERNED ABOUT THE PRECEDENT FOR OTHER DONORS THAT WILL BE SET IF/WHEN USAID CONVERTS FROM A UNITARY TO A MULTIPLE SPECIAL ACCOUNT MANAGEMENT STRUCTURE. IT IS PRECISELY THIS WELL-FOUNDED FEAR OF MULTIPLE DONORS EACH WITH MULTIPLE ACCOUNTS THAT LED THE GRZ (RIGHTLY, WE CONSIDER) TO RESTRICT SPECIAL ACCOUNTS TO ONE PER DONOR IF AT ALL POSSIBLE.

FINALLY, TO REPEAT, OUR DOLLAR PROGRAM IS TOTALLY INTEGRATED TOWARD THE DUAL GOALS OF INCREASING AGRICULTURAL PRODUCTION AND RURAL INCOMES, AND WE NEED A SINGLE COUNTERPART FUNDS ACCOUNT TO ALLOW THE SAME REINFORCING PROGRAMMATIC AND MANAGEMENT INTEGRATION OF COUNTERPART FUNDS. IN SUMMARY, WE DO NOT BELIEVE THAT A MULTIPLICITY OF SEPARATE SPECIAL ACCOUNTS WILL PROVIDE SUFFICIENT BENEFITS AS A CONTROL MEASURE TO JUSTIFY THE LOSS OF RESOURCE INTEGRATION AND THE COSTS OF MAINTAINING SUCH A CUMBERSOME SYSTEM IN LIGHT OF OUR STRAIGHTFORWARD LOCAL CURRENCY PROGRAMMING.

RECOMMENDATION 1(B) CAN BE IMPLEMENTED. HOWEVER, WE BELIEVE THERE IS NOTHING TO BE GAINED BY WITHDRAWING THE BALANCE OF CIP LOCAL CURRENCY FROM ACCOUNT NO. 846 AND REDEPOSITING IT IN A NEW ACCOUNT IN THE BOZ. FOR ONE THING, ALL CIP 601 AND CIP 602 LOCAL CURRENCY HAS BEEN GENERATED AND DEPOSITED. ADDITIONALLY, ALL CIP 601 LOCAL CURRENCY HAS BEEN PROGRAMMED AND EXPENDED RPT EXPENDED. THE CURRENT BALANCE IN THE CIP 602 SUB ACCOUNT IS

K29,341,014.49. AN ADDITIONAL K 3.21 MILLION HAS BEEN "PROGRAMMED" AND IS EXPECTED TO BE RELEASED PRIOR TO 4/30/88, WHICH WILL BRING THE BALANCE DOWN TO K26,131,104.49. COUNTERPART FUNDS PROJECTS FOR K20 MILLION PLUS (COOPERATIVE STORAGE) AND 30 MILLION (WHEAT PRODUCTION DEVELOPMENT) ARE CURRENTLY IN THE DEVELOPMENT STAGES. IT IS ANTICIPATED THAT RELEASES TO THESE ACTIVITIES (K 50 MILLION PLUS) WILL BE MADE CIRCA 7/88. THESE ACTIVITIES WILL DRAW THE CIP 602 ACCOUNT DOWN COMPLETELY. ESTABLISHING A NEW ACCOUNT FOR THE CURRENT BALANCE REMAINING (K29 MILLION) WHEN THE ENTIRE BALANCE IS PROJECTED TO BE EXPENDED PRIOR TO AUGUST, 1988 IS NOT WORTH THE TROUBLE AND IS A SIGNIFICANT WASTE OF BOTH USAID AND GRZ STAFF TIME. FINALLY, USAID HAS NO FIRM PLANS AT THIS TIME FOR ANOTHER CIP FOR ZAMBIA. THEREFORE, THE TIME AND EFFORT SPENT SETTING UP A NEW CIP SPECIAL ACCOUNT WOULD MOST LIKELY NOT HAVE ANY REAL BENEFITS, CERTAINLY NOT IN THE SHORT RUN, AND VERY POSSIBLY NOT IN THE LONG RUN. OUR RECOMMENDATION IS THAT THIS RECOMMENDATION BE REMOVED FROM THE FINAL REPORT, SINCE WE INTEND TO FOLLOW AFRICA BUREAU GUIDANCE ON THE ESTABLISHMENT OF SPECIAL ACCOUNTS IF AND WHEN THE MISSION DEVELOPS ANOTHER CIP.

10. RECOMMENDATION 1 (C): WHILE NOT IN AGREEMENT THAT THE RECOMMENDED COURSE OF ACTION WILL NECESSARILY RESULT IN IMPROVED MANAGEMENT OF OR ACCOUNTABILITY FOR LOCAL CURRENCY (FOR THE REASONS STATED IN PARAGRAPH 9 ABOVE), USAID/ZAMBIA WILL

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FOLLOW AFRICA BUREAU GUIDANCE ON THE ESTABLISHMENT OF SEPARATE SPECIAL ACCOUNTS FOR ANY NEW CIP AGREEMENTS.

11. RECOMMENDATION 2 (A): WE CONCUR AND WILL IMPLEMENT THIS RECOMMENDATION. ON ANY FUTURE CIP'S, WE WILL CARRY OUT THE FOLLOWING PROCEDURES, OR SIMILARLY EFFECTIVE ARRANGEMENTS, IN FULL COMPLIANCE WITH THE AUDIT RECOMMENDATION.

A. FOR PUBLIC SECTOR PURCHASES FINANCED BY DIRECT LETTERS OF COMMITMENT: WE WILL REQUIRE THAT DEPOSITS OF LOCAL CURRENCY BE MADE IN ACCORDANCE WITH THE PROVISIONS OF THE GRANT PRIOR TO REQUESTING THE AID/WASHINGTON OFFICE OF FINANCIAL MANAGEMENT TO ISSUE THE DIRECT LETTER OF COMMITMENT. ARRANGEMENTS WILL BE MADE WITH A COMMERCIAL BANK IN LUSAKA TO RECEIVE THE DEPOSIT ON BEHALF OF THE GRZ AND TO TRANSFER THE FUNDS TO THE SPECIAL ACCOUNT ESTABLISHED AT THE BANK OF ZAMBIA FOR THE CIP. USAID WILL REQUIRE THE IMPORTER TO PRODUCE THE RECEIPT OF DEPOSIT AT THE APPROPRIATE COMMERCIAL BANK PRIOR TO APPROVING THE FINANCING REQUEST OF THE GRZ. WE WILL ALSO REQUIRE EVIDENCE FROM THE PARTICIPATING COMMERCIAL BANK THAT THE FUNDS HAVE BEEN TRANSFERRED INTO THE SPECIAL ACCOUNT AT THE BANK OF ZAMBIA. USAID WILL MAINTAIN ITS OWN ACCOUNTING SYSTEM TO RUN PARALLEL TO THE CURRENT GRZ SYSTEM UNDER WHICH USAID RELIES ON RECEIPT OF STATEMENTS FROM THE BOZ. THE PROPOSED SYSTEM WILL THUS ELIMINATE THE POSSIBILITY OF LATE REPORTING OR UNKNOWN DEPOSITS, EVEN IF THE BOZ ONCE AGAIN EXPERIENCES PROBLEMS SUCH AS A MAJOR COMPUTER BREAKDOWN.

B. FOR PRIVATE OR PUBLIC SECTOR PURCHASES FINANCED BY BANK LETTERS OF COMMITMENT AND COMMERCIAL LETTERS OF CREDIT: WE WILL REQUIRE THAT DEPOSITS OF LOCAL CURRENCY BE MADE IN ACCORDANCE WITH PROVISIONS OF THE GRANT PRIOR TO AUTHORIZING THE PARTICIPATING LOCAL COMMERCIAL BANK TO ISSUE A LETTER OF CREDIT. THIS WILL EASILY BE ACCOMPLISHED THROUGH THE NORMAL AID BANK L/COM AND COMMERCIAL LETTER OF CREDIT PROCESS AS FOLLOWS. FIRST, USAID WILL APPROVE A FINANCING REQUEST FROM THE MOF TO ESTABLISH A BANK LETTER OF COMMITMENT AT A COMMERCIAL BANK IN THE U.S. A CERTAIN NUMBER OF LOCAL COMMERCIAL BANKS WILL BE APPOINTED BY THE MOF [K12 ZE TE7] SPECIAL ACCOUNT ESTABLISHED FOR THE CIP AT THE BANK OF ZAMBIA AND PROVIDE USAID WITH MONTHLY REPORTS OF BOTH DEPOSITS RECEIVED FROM IMPORTERS AND TRANSFERS OF FUNDS TO THE SPECIAL ACCOUNT.

THIS PROCEDURE WILL ALLOW USAID TO MAINTAIN ITS OWN ACCOUNTING SYSTEM TO KEEP TRACK OF DEPOSITS, THUS

ELIMINATING ANY POSSIBILITY OF DELINQUENT OR
INCORRECT DEPOSITS.

12. RECOMMENDATION 2 (B): IN GENERAL WE DISAGREE
WITH THIS RECOMMENDATION. PRE-PROGRAMMING OF LOCAL
CURRENCY, AS THE PHRASE IS COMMONLY UNDERSTOOD, IS
NOT APPROPRIATE IN ZAMBIA. THE GRZ BUDGETARY
PROCESS CAN CHARITABLY BE DESCRIBED AS SOMEWHAT
CHAOTIC. ALTHOUGH SOME IMPROVEMENTS HAVE BEEN MADE
AND WE CAN EXPECT OTHERS IN DUE COURSE, THE CENTRAL
BUDGETARY PROCESS IS NOT SOPHISTICATED ENOUGH TO
PROGRAM MUCH COUNTERPART THROUGH THE BUDGET.
PRE-PROGRAMMING COUNTERPART IN LARGE AMOUNTS VIA A
RIGID OR SEMI-RIGID LISTING OF DISCRETE ACTIVITIES
TO BE FUNDED WOULD BE TANTAMOUNT TO A SHADOW BUDGET,
SOMETHING WE WOULD LIKE TO AVOID. ALTHOUGH WE ARE
WORKING WITH THE GRZ TO MORE FULLY INTEGRATE OUR
(AND OTHER DONORS') COUNTERPART INTO THE BUDGETARY
PROCESS, WE HAVE A LONG WAY TO GO. SETTING UP A

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PARALLEL PROGRAMMING STRUCTURE WOULD MOST LIKELY HINDER THE ATTAINMENT OF THAT GOAL.

AS WE POINTED OUT NUMEROUS TIMES TO THE RIG/A AUDITORS, PROGRAMMING ALL COUNTERPART WHEN AN AGREEMENT IS SIGNED IS ACTUALLY COUNTERPRODUCTIVE. PROGRAMMING OF LOCAL CURRENCY IN ZAMBIA WOULD HAVE TO INVOLVE SOME FORMALIZATION OF USAID--GRZ AGREEMENT THAT THE FUNDS WILL BE USED FOR SPECIFIC PURPOSES. TYPICALLY, COUNTERPART FUNDS ARE GENERATED ONE TO TWO YEARS AFTER AN AGREEMENT IS SIGNED. NEITHER USAID NOR THE GRZ WOULD FIND IT VERY USEFUL TO FIND THEMSELVES IN A POSITION OF HAVING AGREED TO USES OF COUNTERPART THAT NO LONGER MAKE SENSE WHEN IT IS TIME TO SPEND THE FUNDS.

WE BELIEVE THAT AT THE ROOT OF THIS RECOMMENDATION IS THE RIG/A IMPRESSION THAT USAID DOES NOT AGGRESSIVELY PROGRAM COUNTERPART FUNDS. WE WOULD LIKE TO POINT OUT THAT PROGRAMMING CAN BE A STATIC OR A DYNAMIC PROCESS; OBVIOUSLY WE HAVE CHOSEN THE LATTER. FOR EXAMPLE, WE ARE CURRENTLY IN THE PROCESS OF DEVELOPING TWO NEW COUNTERPART FUNDS PROJECTS FOR WHEAT PRODUCTION DEVELOPMENT (K 30 MILLION) AND FOR RURAL COOPERATIVE STORAGE (K 20 PLUS MILLION). WE INTEND TO CONTINUE THIS PROCESS, DEVELOPING PROJECTS TO ASSIST ZAMBIA'S DEVELOPMENT IN THE AGRICULTURAL AND RURAL SECTORS IN THE CONTEXT OF OUR APPROVED STRATEGY. FURTHERMORE, WE ANTICIPATE EXPENDING ALL OF THE COUNTERPART FUNDS CURRENTLY AVAILABLE DURING FY'S 1988 AND 1989. FOR A NUMBER OF REASONS (THE POSSIBLE PHASE DOWN OF THE USAID/ZAMBIA PROGRAM DUE TO BROOKE AMENDMENT CONSTRAINTS, THE NEED TO PROGRAM COUNTERPART FUNDS RATIONALLY TO CONTINUE DEVELOPMENT ACTIVITIES DURING SUCH A PERIOD, AND THE NEED, ADMITTEDLY SOMEWHAT TIME CONSUMING, TO DEVOTE THE TIME AND PROFESSIONAL EFFORT TO ENSURE THAT THE ACTIVITIES ARE SOUND, IMPLEMENTABLE AND APPROPRIATE), USAID/ZAMBIA DOES NOT AND CANNOT CONSIDER A DRASTIC INCREASE IN THE CURRENT RATE OF EXPENDITURE OF THE RESOURCE.

USAID WILL CONTINUE TO PROGRAM COUNTERPART FUNDS AS RAPIDLY AS POSSIBLE, AND WILL ACCELERATE PROGRAM APPROVAL WHEREVER POSSIBLE. IN FACT, SOME PREPROGRAMMING IS ALREADY BEING DONE, E.G., THE K115 MILLION GENERATED UNDER THE ZAMBIA AUCTION PROGRAM SUPPORT (ZAPS) PROGRAM 611-2757. YET WE CANNOT PRECLUDE REACHING TARGETS OF OPPORTUNITY FOR BENEFICIAL PROGRAMMING WHICH MAY ARISE AT A LATER DATE BECAUSE WE CHOSE TO PRE-PROGRAM ALL FUNDS WHEN THE AGREEMENT WAS SIGNED. IN ADDITION TO JUDICIOUS PROGRAMMING, RESTRAINT IN AVOIDING DUMPING OF COUNTERPART INTO THE ECONOMY FOR THE SAKE OF SPEED IS EMINENTLY JUSTIFIABLE IN FIGHTING INFLATION IN

ZAMBIA. IT IS A FACT THAT A PRIMARY CAUSE OF INFLATION HERE IS THE RAPID, UNCHECKED GROWTH OF THE MONEY SUPPLY. PRUDENT ECONOMICS IN ZAMBIA DICTATES THOUGHTFUL PROGRAMMING INTO HIGHLY PRODUCTIVE ACTIVITIES INSTEAD OF HASTY EXPENDITURES JUST TO "BEAT INFLATION". IN SOME USAID PROGRAMS (E.G., INDIA AND LAOS), THE COUNTERPART FUNDS ACCOUNTS HAVE APPROPRIATELY BEEN "FROZEN", OR "STERILIZED", IN ORDER TO DAMPEN THE GROWTH OF THE MONEY SUPPLY. YOU SIMPLY DO NOT BEAT INFLATION BY FUELING IT, AND CONCERNS ABOUT RAPIDLY SPENDING COUNTERPART TO PREVENT THE REDUCTION IN THE REAL VALUE OF OUR LOCAL CURRENCY CANNOT AND WILL NOT BE THE DRIVING --- OR EVEN A PRIMARY --- FORCE BEHIND OUR COUNTERPART FUND PROGRAMMING. HOWEVER, WE WILL CONTINUE TO REQUIRE THAT THE ANALYTICAL BACKGROUND WORK ESSENTIAL TO DEVELOPMENT OF SOUND AND APPROPRIATE ACTIVITIES BE DONE.

13. RECOMMENDATION 2 (C): USAID HAS IN PLACE TWO MAJOR PROJECTS, ZAMBIA AGRICULTURAL TRAINING, PLANNING AND INSTITUTIONAL DEVELOPMENT (ZATPID II, 611--2207) AND HUMAN AND INSTITUTIONAL RESOURCES DEVELOPMENT (HIRD, 611-2206), INTEGRAL PARTS OF WHICH ARE "IDENTIFICATION OF THE SPECIFIC TRAINING NEEDS AND INSTITUTIONAL NEEDS OF THE GOVERNMENT OF ZAMBIA TO PERFORM LONG TERM PLANNING RELATIVE TO DEVELOPMENT ACTIVITIES", PRIMARILY IN THE AGRICULTURAL SECTOR, BUT ALSO IN THE NATIONAL COMMISSION FOR DEVELOPMENT PLANNING, CENTRAL

STATISTICS OFFICE AND THE MINISTRY OF FINANCE. WE SUGGEST THAT THIS RECOMMENDATION HAS ALREADY BEEN FULLY IMPLEMENTED, AND SHOULD BE DELETED FROM THE AUDIT REPORT.

14. RECOMMENDATION 2 (D): THE ZATPID II (611-0207) PROJECT IS STRUCTURED TO PROVIDE THE GOVERNMENT OF ZAMBIA WITH LONG TERM PLANNING CAPABILITY. LONG-TERM TECHNICAL ADVISORS ARE WORKING IN THE MINISTRY OF AGRICULTURE AND WATER DEVELOPMENT (PLANNING DIVISION), THE CENTRAL STATISTICS OFFICE AND THE NATIONAL COMMISSION FOR DEVELOPMENT PLANNING. OUR APPROVED STRATEGY IS RESTRICTED TO THE AGRICULTURAL SECTOR, AND PERIPHERAL BUT LINKED SUB-SECTORS SUCH AS SMALL-SCALE ENTERPRISE DEVELOPMENT IN RURAL AREAS. THE GOALS OF THE ZATPID PROJECT AND THE HIRD PROJECT ARE ENTIRELY CONGRUENT WITH THE AMBIT OF THIS RECOMMENDATION IN THE CONTEXT OF OUR STRATEGY. COPIES OF THE PROJECT PAPERS FOR THE TWO PROJECTS (ZATPID II AND HIRD) MAY BE OBTAINED IN THE REDSO/NSA LIBRARY. WE RECOMMEND THAT THIS RECOMMENDATION BE DELETED FROM THE FINAL AUDIT REPORT. HARE

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