PD-AAY-076

ISN=57201

AUDIT OF
CASH ADVANCES TO PROJECTS
IN KENYA

AUDIT REPORT NO. 3-615-88-19
July 28, 1988

UNITED STATES OF AMERICA

AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT

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July 28, 1988

MEMORANDUM FOR MISSION DIRECTOR, USAID/Kenya, Steven W. Sinding

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

SUBJECT: Audit of Cash Advances to Projects in Kenya

The Office of the Regional Inspector General for Audit, Nairobi has completed its audit of A.I.D. cash advances to projects in Kenya. 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 one recommendation. Part 1a. of the recommendation is considered closed since recommended action was taken during the audit. Part 1b. of the recommendation is considered resolved, but requires further action before it can be closed. Please advise me within 30 days of any additional information relating to actions planned or taken to implement part 1b. of the recommendation.

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

Background

USAID/Kenya was one of fourteen A.I.D. missions in eastern Africa serviced by the Regional Financial Management Center (RFMC) located in Nairobi, Kenya. The financial services provided by RFMC/Nairobi to client missions depended on the type of financial staff available at specific missions. At USAID/Kenya, there was no financial staff assigned. Accordingly, all financial services were provided by RFMC/Nairobi which was jointly located with the USAID/Kenya staff. However, USAID/Kenya had received approval to establish its own Controller operations and was in the process of doing so. Among the various financial transactions initiated by USAID/Kenya officials were advancement of funds to A.I.D. funded development projects. Periodically, RFMC/Nairobi sent financial reports to USAID/Kenya to reflect the action taken relative to cash advance transactions, since RFMC/Nairobi maintained the official accounting records. These reports were intended to facilitate USAID/Kenya project officer monitoring of cash advances. As of September 11, 1987, USAID/Kenya had $1,998,439 of cash advances outstanding.

Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Nairobi made an economy and efficiency audit of cash advances to A.I.D. funded projects in Kenya. The audit objective was to determine if cash advances were being managed economically and efficiently. Specific objectives were to (1) determine if project advances approved by USAID/Kenya officials were appropriate, and (2) evaluate USAID/Kenya monitoring of cash advances.

The audit was made at RFMC/Nairobi and at USAID/Kenya in Nairobi, Kenya (see Exhibit 1), during the period October 21, 1987 to January 29, 1988. RFMC/Nairobi and USAID/Kenya officials were interviewed, project files and financial reports were reviewed, and related internal controls were tested. The audit scope included $1,998,439 of cash advances outstanding to 19 projects as of September 11, 1987 of which $1,963,049 outstanding to 11 projects was tested. Tests of internal controls were limited to the findings presented in this report. The audit was conducted in accordance with generally accepted government auditing standards.

Results of Audit

USAID/Kenya's procedures for making advances were inappropriate since the Mission's practice was to make advances for 90-day disbursement needs rather than 30-day disbursement needs as required by regulations; some Mission project officials were not effectively monitoring cash advances; and related internal controls were not being implemented. Those weaknesses resulted in some unnecessary cash advances to two project recipients, late receipt of advances by other recipients which could threaten project implementation, and some unnecessary interest costs to the U.S. Government. Therefore, we recommended that cash advances, other than the initial advance, be limited to cover 30 days of disbursement needs, and that USAID/Kenya establish procedures to regularize the monitoring of cash advances.

Since June 1987, USAID/Kenya had made improvements in its management of cash advances. These improvements were prompted by a special RFMC/Nairobi effort initiated in May 1987 to liquidate some long outstanding advances and to correct errors in the accounting records.

Additional Improvement in the Management of Cash Advances Can Be Made - U.S. Treasury and A.I.D. regulations required that cash advances be limited to immediate disbursing needs (i.e., not more than 30 days) unless a longer period was justified.

In addition, A.I.D. regulations required that unused funds be promptly returned to the U.S. Treasury. The intent of those regulations was to minimize interest costs to the U.S. Government. However, in two cases, USAID/Kenya had given excessive cash advances to project recipients. In other cases, advances were made late. This occurred because USAID/Kenya officials were not adhering to cash advance criteria and USAID/Kenya had no uniform procedures for monitoring cash advances. As a result, unnecessary interest costs were incurred in some cases and could have delayed project implementation in others.

Discussion - U.S. Treasury regulations and A.I.D. Handbook 19, Chapter 1, page 1B-8 required that cash advances should be provided in minimum amounts required to meet recipients' immediate disbursing needs. Immediate disbursing need was defined to mean cash requirements of up to 30 days. The Handbook also provided that if project implementation would be seriously interrupted or impeded by the 30-day rule, then advances could be provided to cover up to 90 days; however, written justification for any period beyond 30 days had to be approved by the appropriate Bureau Assistant Administrator in AID/Washington or the overseas A.I.D. representative. In addition, page 1B-7 of that Chapter required that cash management practices of recipient organizations be monitored by A.I.D. to ensure that excessive cash balances were promptly returned to the U.S. Treasury. The intent of those requirements was to minimize U.S. Government costs associated with cash advances, and also to allow orderly project implementation.

The audit determined that a lengthy processing period of up to 65 days was involved before a cash advance was actually received by project recipients. Up to 14 days was required for an advance request to be prepared by the recipient, including preparation of the disbursement schedule justifying the need for the funds. The advance request was then forwarded to the USAID/Kenya project officer for administrative approval which took up to seven days more. After project officer approval, the request was forwarded to RFMC/Nairobi where processing took up to 30 days. After RFMC/Nairobi processing, a cable was sent to the Regional Administrative Management Center in Paris, France which issued the check and forwarded it to the recipient - another 14 days. On this basis, the processing time took up to 65 days before the recipient received the funds. According to RFMC officials, the costs to the U.S. Government for processing an advance was about $90.

Because of the lengthy processing time and associated processing costs, the audit determined that an initial advance to cover disbursements up to 90 days was often appropriate.

Subsequent advances, however, should have been limited to 30-day disbursement requirements. This method would have allowed project officials sufficient time to determine the processing time necessary for a particular recipient, to establish a disbursement history which could be used to analyze future advances, and would have minimized costs to the U.S. Government.

The audit revealed that USAID/Kenya was approving and granting advances based on a 90-day disbursements requirement for the initial and subsequent advances. According to some USAID/Kenya officials interviewed, it was believed that approving cash advances to cover 90 days of disbursement needs was the standard operating practice in eastern Africa. Some officials were also unaware of the requirement to justify cash advances exceeding 30 days of cash disbursement needs. The audit also revealed that USAID/Kenya had no procedures to ensure the periodic review of cash advances and some project officers were not effectively monitoring cash advances. Rather, project officers were usually reviewing cash advances only when replenishment vouchers were submitted. The combined effect of giving 90-day advances and ineffective monitoring resulted in some recipients getting more funds than needed and others receiving less than needed.

For example, World Education Inc. began receiving cash advances in May 1984 to implement a project. The advances were based on 90-day disbursement needs. By March 1986, World Education had accumulated enough excess cash to cover its actual disbursement needs through November 1986 (an eight-month period). Yet, in September 1986, World Education was granted additional advances totalling $1,460,871. This occurred because the project officer responsible for monitoring the project and attesting to funds usages was unaware that World Education had been inadvertently over-reporting actual disbursements. Overall, the excess amounts provided to World Education between October 1984 and September 1987 cost the U.S. Government about $89,830 in additional interest costs.

In another case, the recipient initially received a $190,881 advance to cover projected disbursements for the initial 90 days of the project. In actuality, the initial advance covered disbursements for more than six months since some vehicles were not procured as planned. Even though the recipient was supposed to submit quarterly vouchers to report actual disbursements, actual disbursements were not reported until six months after the advance was made. Had the USAID/Kenya project officer been aware that the vehicles were not purchased, steps could have been taken to recover the excess funds advanced for their purchase.

In other cases, however, the audit determined that recipients received the advances after reported disbursements were made. A voucher review indicated that this often occurred because advance requests were not received and processed in time for advances to be received before disbursements. The audit did not determine the effect of this practice on project implementation. However, the audit did note that either reported disbursements were not actually made, or recipients had sufficient working capital of their own to finance the project until disbursements were reimbursed by A.I.D. or project implementation was delayed until advance funds were received. In any case, USAID/Kenya project officers should have been aware of the situation and the potential implications.

Some USAID/Kenya project officers stated that it would be impossible for recipients to work with only 30-day cash advances. The auditors disagreed with this position and suggested the following approach. First, assume the recipient was given an initial 90-day advance at the beginning of the project. During the first 30 days of that period, the recipient would have established a disbursement history which could be considered in submitting a replenishment voucher. In addition, in submitting the original advance request, the recipient and the USAID/Kenya project officer would have established a reasonable estimate of the time necessary to process the voucher for a particular recipient. With this information, the recipient was in a position to submit its next voucher. Assuming it actually took sixty days to process the voucher for that recipient, the recipient then started processing the next voucher 30 days after he received the initial advance. Subsequent voucher would also have been processed every 30 days. This procedure would have ensured the recipient had the advance funds when needed and USAID/Kenya would have been in compliance with advance criteria. Exhibit 2 reflects how this process would work and shows the interest savings of this method versus giving continuous 90-day advances.

Because USAID/Kenya was giving 90-day cash advances and project officers were not effectively monitoring cash advances, some recipients received excess funds prior to need which resulted in excess costs to the U.S. Government. In other cases, recipients received advances late which could have disrupted project implementation.

<u>Recommendation No. 1</u>

We recommend that the Director, USAID/Kenya:

a. require that new cash advances are made in compliance with Agency cash advance policy which limits advances to 30-day disbursement needs unless otherwise appropriately justified and waived.

b. incorporate a quarterly review of cash advances in the Mission's quarterly Project Implementation Review.

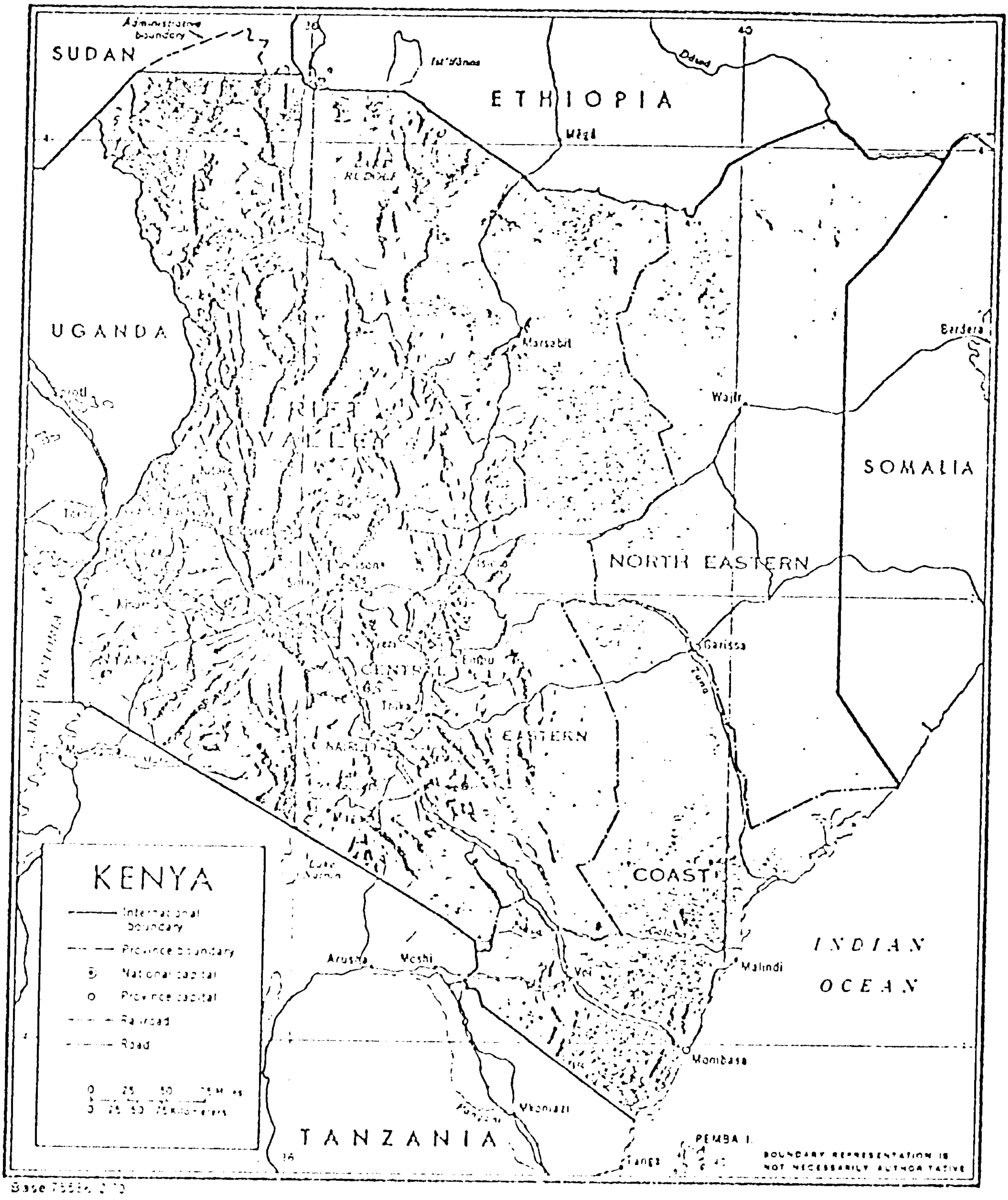
USAID/Kenya officials generally agreed with the report findings and recommendations (see Appendix 1).

<u>Other Pertinent Matters</u> - A.I.D. Handbook 1, Supplement B, section 15B.1a stated that advances to profit making organizations were the least preferred method of financing since they involved greater risk to the U.S. Government, required close supervision and entailed additional administrative costs. Handbook 11, Chapter 1, section 3.6.5.2c provided that advance payments to profit making contractors may be authorized only when the approving official has made a positive written determination that A.I.D. will benefit by increased competition and/or lower prices. The audit identified that USAID/Kenya had been providing advances to profit making organizations, such as Louis Berger and Associates, without the required approvals and justification. All such advances, current and future, to profit making organizations should be justified and approved in accordance with Handbook requirements.

AUDIT OF
CASH ADVANCES TO PROJECTS
IN KENYA

EXHIBITS AND APPENDICES

Exhibit 1



SUDAN
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UGANDA
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RIFT VALLEY
NORTH EASTERN
CENTRAL
EASTERN
COAST
Marsabit
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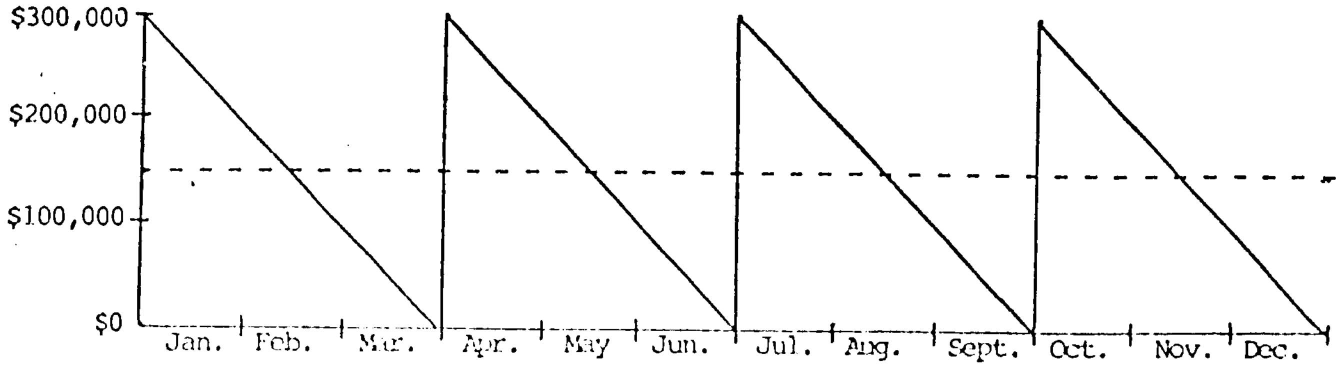
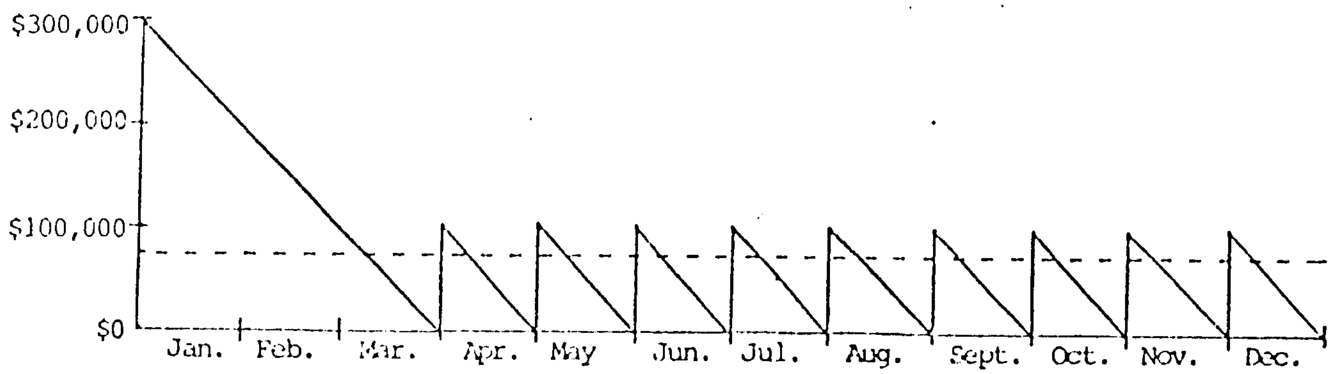
Bardera
Garissa
Embu
Thika
Malindi
Mombasa
Voi
Arusha
Moshi
INDIAN OCEAN
TANZANIA
PEMBA I.
BOUNDARY REPRESENTATION IS NOT NECESSARILY AUTHORITATIVE
KENYA
International boundary
Province boundary
National capital
Province capital
Railroad
Road

Illustration of Interest Savings
Associated With 30 day V. 90 Day Advances
Based on $100,000 Monthly Cash Needs

Current Practice - 90-Day Advances



Proposed Practice - 90-Day Initial Advance, 30-Day Subsequent Advances



LEGEND

__________ Cash on Hand

\- - - - - - - - Average Cash Balance

ASSUMPTIONS

(1) Equal monthly cash needs of $100,000.
(2) Recipient cash disbursements are level throughout each month.

RESULTS

(1) Current practice results in recipient having $150,000 average cash balance during first year. U.S. Government interest cost is $12,000 based on 8 percent current value of funds rate.

(2) Proposed practice results recipient having $75,000 average cash balance. U.S. Government interest costs is $6,000.

(3) Interest cost during subsequent years would be the same for current practice (assuming same current value of funds rate); however, cost drops to $4,000 under proposed practice since initial advance of $300,000 would not be required.

(4) Processing costs would increase from $360 ($90 transaction costs x 4 vouchers) to $1080 ($90 transaction cost x 12 vouchers).

(5) Overall savings to U.S. Government would be $5,460 (6,000 interest savings minus $540 additional processing costs) during first year and $7,280 during subsequent years.

UNITED STATES GOVERNMENT

memorandum

DATE: July 8, 1988

REPLY TO ATTN OF: Larry Hausman, Acting Director, USAID/Kenya

SUBJECT: Draft Audit Report of Cash Advances to Projects in Kenya

TO: David M. Conner, RIG/A/N

We have received copies of the subject draft report and appreciate this opportunity for final comments. During the course of the audit and in interim discussions we elaborated our views with respect to the various points as now contained in the draft report. The essence of those discussions was that we accepted factual evidence as was presented but were not in complete agreement on broader assumptions made or conclusions which were drawn from that evidence. In accepting that particular advances were in excess of requirements, we do not view this as sufficient basis for broadly concluding that 90-day advances without justification in writing must as a result be deemed unwarranted and excessive or of unneccessary cost to the USG. With this perspective in mind, we are in otherwise general agreement with the audit report presentation.

We have no objection to the recommendation as presented. As indicated, actions were undertaken some time ago which should resolve recognized deficiencies (see attached - Cash Advance Guidance).

WP ID 0149A

OPTIONAL FORM NO. 10
(REV. 1-80)
GSA FPMR (41 CFR) 101-11.6
5010-114
★ USGPO 1986 491-248/40111

ITED STATES GOVERNMENT

memorandum

DATE: December 16, 1987

REPLY TO ATTN OF: Albert D Hulliung, Director, RFMC

SUBJECT: Cash Advance Guidance

TO: See Distribution

1. USG cash advance policy, which AID's cash management procedures are consistent with, is premised on the principle that advances should not be granted unless absolutely essential since the cost of Treasury borrowing is a considerable burden on the U.S. taxpayer. When deemed to be essential, the amount of advances should not exceed the immediate minimum needs of the recipient. Treasury has defined minimum needs as being no more than a 30 day requirement of cash on hand.

2. When cash advances have been determined to be essential (reasons should be documented in official files) the following procedure (which is widely practiced) has been accepted as being generally consistent with cash management policies:

- When an activity commences, the grantee will provide a projection of cash requirements over a specified period (normally 3 months/by month).

- Based on an analysis of this projection, the amount of the initial advance will be determined. The analysis normally considers the initial month's requirements, the time needed by the grantee to account for the month's activity and prepare a voucher, and the time required to process the voucher and make payment.

- Subsequent monthly vouchers normally; (1) account for the previous months activity, (2) update cash requirement projections and (3) request an adjustment to the advance.

3. If circumstances surrounding the activity do not lend themselves to the above procedure, then variations can be made as long as the "30 days cash requirement" rule is addressed. An example of an acceptable variation might be the monthly tranching of advance adjustments based solely on revised cash projections. The accounting for the advances could cover a longer period (quarterly/semi-annual) depending on the peculiar circumstances surrounding the project activity.

OPTIONAL FORM NO. 10
(REV. 1-80)
GSA FPMR (41 CFR) 101-11.6
5010-114

4. RFMC will support any mechanism where the integrity of the 30 day cash requirement is maintained and the accounting is adequate and carried out in a reasonable period of time. Actual liquidation of the advance is not as important as the amount of cash in the bank.

5. It is extremely difficult to come up with a rationale which justifies cash balances in excess of 30 days; however, if such a situation exists, it should be fully documented and the advance monies should be placed in interest bearing accounts. Interest earned on such balances would be refunded to the U.S. Treasury as a partial offset to its additional borrowing costs.

6. It is also difficult to envision a grantee who cannot either account for monthly expenditures or provide reasonable cash requirement projections on a timely basis. If the grantee can't do this, he is not qualified to be an advance recipient.

7. The easiest way to look at advance policies and procedures is to assume that you are dealing with your own savings. Early withdrawals or delayed deposits impact on personal earnings. If you apply what should be your personal practices to AID activities, you will certainly be operating within the USG's cash management policies.

Distribution:

RFMC - All USDH
USAID - S Sinding
RIG/A/N - R Thabet
REDSO - S Shah

Appendix 2

REPORT DISTRIBUTION

Mission Director, USAID/Kenya	5
AA/AFR	1
AA/M	2
AA/XA	2
AFR/EA/KUTRB	1
AFR/CONT	1
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GC	1
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M/FM/ASD	2
M/AAA/SER	1
M/SER/MO	1
M/SER/EOMS	1
SAA/S&T	1
PPC/CDIE	3
REDSO/ESA	1
RFMC/Nairobi	1
IG	1
DIG	1
IG/PPO	2
IG/LC	1
IG/ADM/C&R	12
AIG/I	1
RIG/I/N	1
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