

INVESTIGATIVE  
GENERAL



CONFIDENTIAL

AUDIT OF  
MALAWI NORTHERN CORRIDOR  
(SOUTHERN AFRICA REGIONAL)  
PROJECT NO. 690-0237

AUDIT REPORT NO. 3-690-91-01  
OCTOBER 29, 1990

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The Malawi Northern Corridor Project (Southern Africa Regional) progressed satisfactorily towards improving Malawi's access to the port of Dar es Salaam. However, USAID/Malawi:

- . used an inappropriate financing system for construction and construction equipment, and materials were procured from ineligible sources and origin;
  - . gave the Government of Malawi excessive advances for construction;
  - . did not monitor the Government of Malawi's contribution to the project; and
  - . did not adequately address environmental concerns of the project.
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AGENCY FOR INTERNATIONAL DEVELOPMENT  
REGIONAL INSPECTOR GENERAL/AUDIT

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October 29, 199

MEMORANDUM

TO : Carol A. Peasley, Director USAID/Malawi  
FROM : Toby L. Jarman, RIG/A/Nairobi *Toby L. Jarman*  
SUBJECT: Audit of USAID/Malawi's Northern Corridor Project  
(Southern Africa Regional) No. 690-0237,  
Report No. 3-690-91-01

Enclosed are five copies of our audit report on USAID/Malawi's Northern Corridor Project (Southern Africa Regional), Report No. 3-690-91-01.

We have reviewed your comments on the draft report and included them as an appendix to this report. Recommendation Nos. 1, 2.2, 3 and 4 are resolved and will be closed when appropriate actions are completed. Recommendation No. 2.1 is unresolved pending your agreement on the amount of cash advances to be refunded by the Government of Malawi. Please respond to this report within 30 days, indicating any actions planned or already taken to implement the recommendations. For Recommendation No. 2.1 please provide evidence of the recovery of the specified amount of cash advances returned by the Government of Malawi.

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

## EXECUTIVE SUMMARY

Started in July 1986, the Malawi Northern Corridor Project (Southern Africa Regional) was designed to provide Malawi with a more reliable and cost effective option for international transport. The project is to improve Malawi's access to Tanzania's port of Dar es Salaam by providing, in conjunction with other donors, a northern transport corridor to Dar es Salaam, including road, lake and rail transit systems. To achieve this, A.I.D. authorized \$19.1 million to the Government of Malawi (GOM) in life-of-project funding--about \$10.8 million for construction purposes and the majority of the remaining \$8.3 million for commodity procurement. As of March 22, 1990, total payments were about \$9.8 million, most in the form of advances. In addition, the GOM agreed to provide the local currency equivalent of \$4 million in resources, of which \$3.1 had been provided as of March 22, 1990.

Between January 29 and March 22, 1990 we audited the project in accordance with generally accepted government auditing standards (see Appendix I) and found the following:

- . The project had progressed satisfactorily towards improving Malawi's access to the port of Dar es Salaam. Further, there was adequate coordination to ensure project elements were interconnected and completed on a timely basis (see page 5).
- . USAID/Malawi used an inappropriate method to finance construction; further, it did not have adequate controls over the procurement of commodities, construction equipment and materials. As a result, about \$2.6 million of materials and equipment were purchased from ineligible sources (see page 8).
- . Disbursements were made in accordance with applicable laws and regulations except that excessive advances were provided to the GOM resulting in unnecessary interest costs to the U.S. Government of about \$383,000 (see page 13).
- . USAID/Malawi did not establish a monitoring system to ensure that the GOM was contributing resources as agreed (see page 19).
- . Environmental concerns were not adequately resolved (see page 20).

The report contains four recommendations, principally for the Mission Director to:

- . obtain a properly authorized source and origin waiver for \$2.6 million;
- . require the GOM to refund cash advances totalling \$501,403;
- . implement a monitoring system to ensure the GOM's resource contributions are made; and
- . assist in developing a plan for the GOM's regulation of shipping hazardous materials on Lake Malawi.

USAID/Malawi accepted all recommendations and intended to implement them in a timely fashion.

The report also presents our assessment of internal controls (see page 23), and includes a summary of significant areas of noncompliance with applicable laws and regulations (see page 26).

*Office of the Inspector General*

Office of the Inspector General  
October 29, 1990

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## INTRODUCTION

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### Background

The overall goal of the Malawi Northern Corridor Project (Southern Africa Regional) is to provide Malawi with a more reliable and cost effective option for international transport. This is to be accomplished by improving Malawi's access to the coastal port of Dar es Salaam by providing, in conjunction with other donors, a comprehensive northern transport corridor through Malawi and Tanzania, along with the necessary linkages with road, lake and rail transit systems (see map, page 4).

The major components of the project are commodity procurement and construction, both implemented through host country contracts. Specifically, the project is to provide (1) upgraded dry goods and fuel facilities at the Lake Malawi ports of Chipoka and Chilumba, (2) upgraded facilities for ship repair and maintenance at the Lake Malawi port of Monkey Bay, (3) selected moveable equipment for Malawi Cargo Centers at Mbeya and Dar es Salaam in Tanzania, and (4) fuel tanktainers and railway tankers for fuel transport.

The project was initiated on July 24, 1986 and was to be completed by October 31, 1989 at a cost of \$10.5 million. However, the project has experienced substantial delays and increased costs. On March 7, 1989 the project was amended increasing the grant to about \$19.1 million and extending the completion date to June 30, 1991.

Of the \$19.1 million, \$10.8 million was for construction. As of January 28, 1990, A.I.D. had provided about \$8.9 million for that purpose. Most of the remaining \$8.3 million of funding was for the commodity procurement component of the project, of which about \$0.9 million had been advanced as of the same date. Exhibit 1 shows A.I.D. funds planned, obligated, and expended as of January 28, 1990. The GOM agreed to provide \$4 million to the project, which included costs borne on an in-kind basis.

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### Audit Objectives

The Office of the Regional Inspector General for Audit/Nairobi audited the Malawi Northern Corridor Project (Southern Africa Regional) to answer the following audit objectives:

1. What is the progress of the project?
2. Did USAID/Malawi and the GOM adequately plan for, and did USAID/Malawi appropriately finance, the procurement of construction services, commodities and materials; and were source and origin rules for procurement of goods followed?
3. Were disbursements made in accordance with applicable laws and regulations?
4. Did the Government of Malawi contribute resources as agreed?
5. Were environmental concerns adequately resolved?

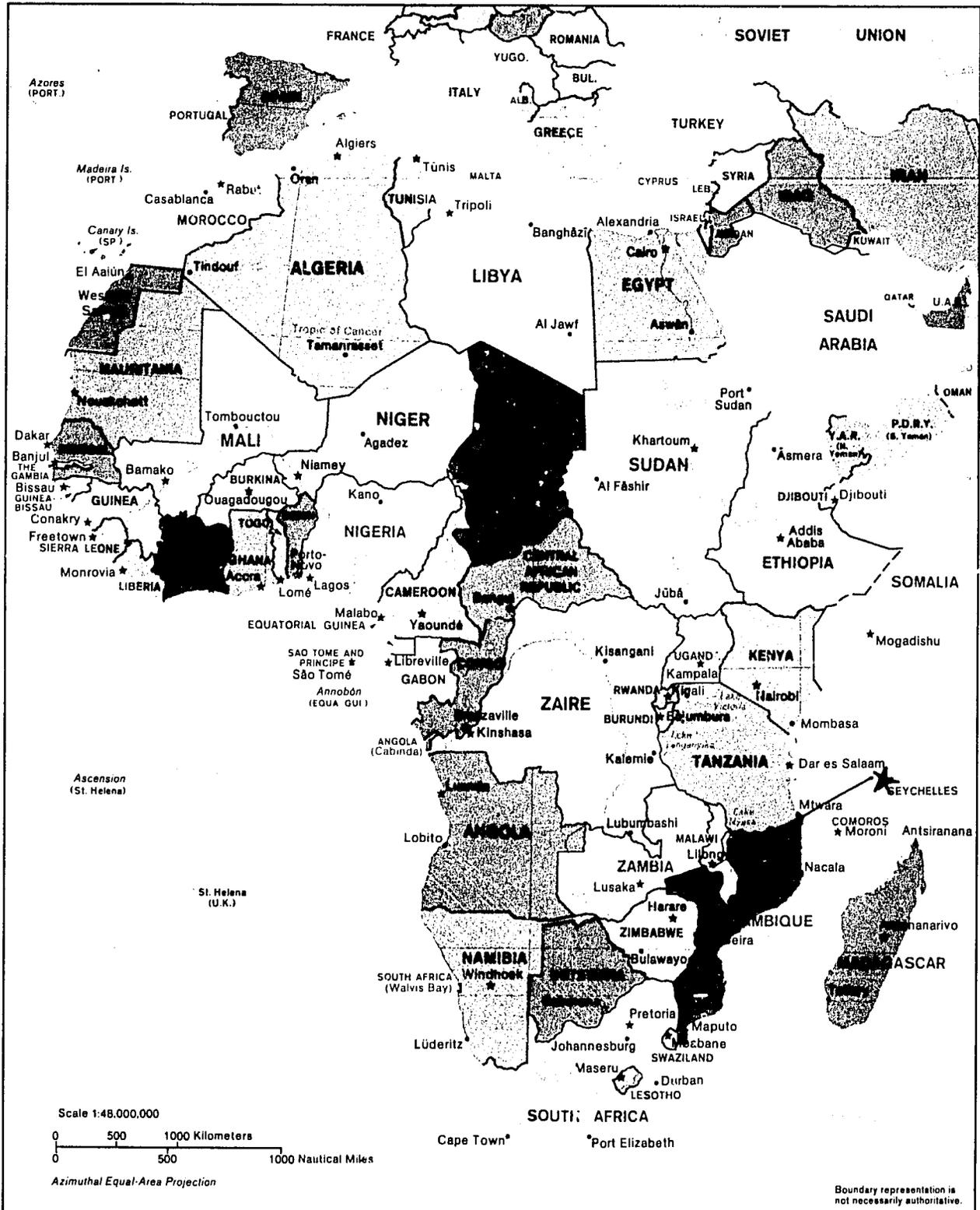
In answering these audit objectives, we tested whether USAID/Malawi and the GOM followed applicable procedures and complied with certain provisions of laws, regulations, contracts and the grant agreement. Our tests were designed to provide reasonable--but not absolute--assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. We did not continue testing when we found that, for the items tested, USAID/Malawi and the GOM followed A.I.D. procedures and complied with legal requirements. Our conclusions were therefore based on the items actually tested.

Appendix I contains a complete discussion of the scope and methodology for this audit.

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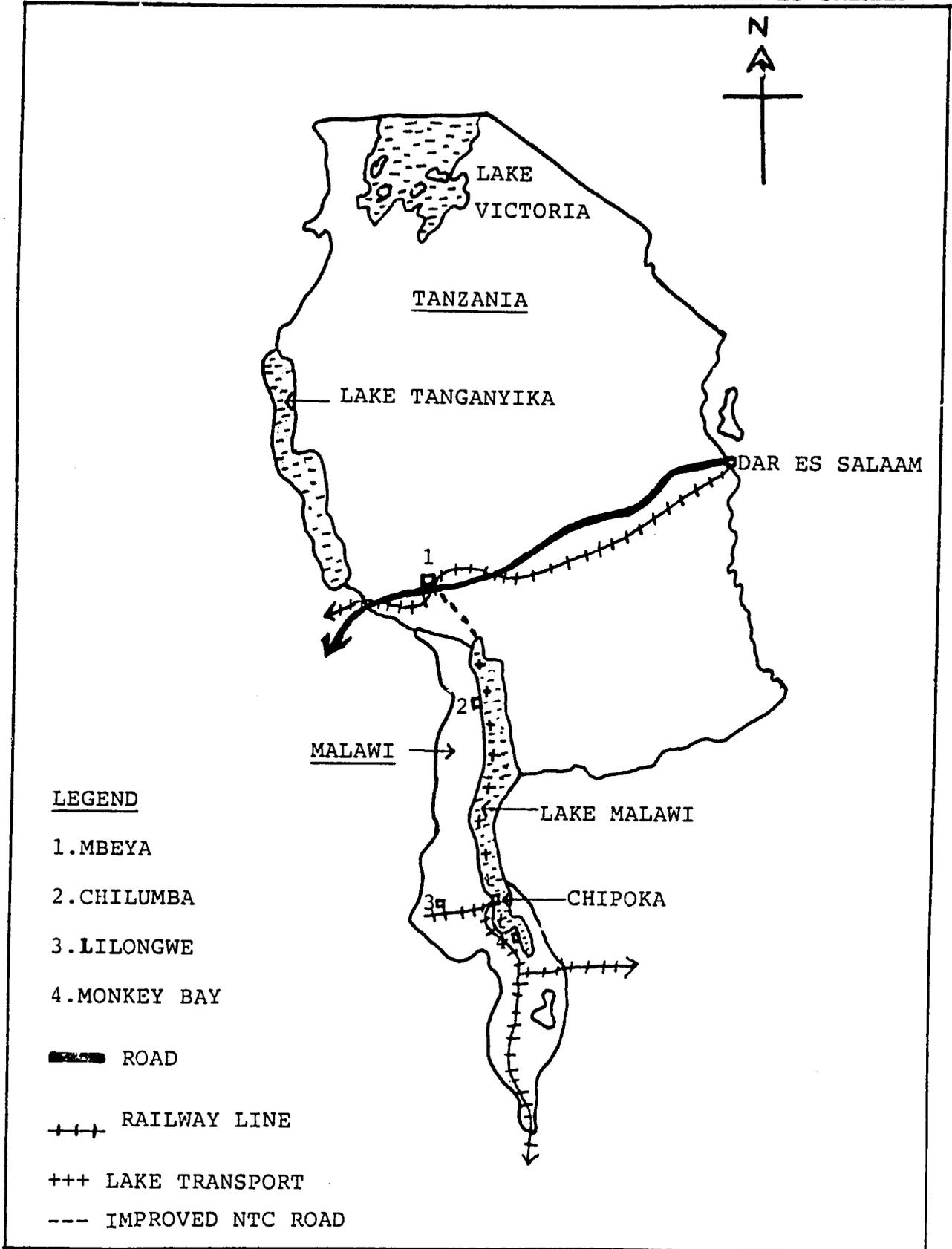
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# Africa



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MAP: THE NORTHERN TRANSPORT CORRIDOR THROUGH DAR ES SALAAM



**REPORT OF  
AUDIT FINDINGS**

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**What is the progress of the project?**

We found that the project had progressed satisfactorily towards improving Malawi's access to the port of Dar es Salaam. In addition, the audit found that the overall project coordination had been very good, with USAID/Malawi and other A.I.D. officials contributing extensively to the project.

The progress of the overall multi-donor project was inherently dependent upon close coordination among all donors and the Government of Malawi, as well the cooperation of the Government of Tanzania (GOT). The GOT's cooperation was necessary because an agreement was needed between the GOM and Government of Tanzania regarding land rights--in fact, it was a condition precedent in the Project Agreement--for the construction of the port facilities at Dar es Salaam and for the construction of the cargo trans-shipment facility at Mbeya, located in Tanzania just north of Lake Malawi.

Obtaining the agreement and the necessary land rights proved to take much longer than anticipated by project designers. This contributed significantly to the substantial delay in the overall project implementation, as other donors denied commitment of their funds until the issue was resolved to their satisfaction. Although the land rights issue has indeed resulted in a substantial delay, USAID/Malawi's and the GOM's efforts were commendable in bringing about a solution.

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**Construction and commodities financed by  
A.I.D. will be an integral part of the  
overall multi-donor transportation system.**

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In spite of this delay, USAID/Malawi's contributions towards the overall project were well underway and it appeared that construction and commodities financed by A.I.D. would be an integral part of the overall multi-donor transportation system. Further, although behind schedule, other donors' projects--including port facilities, cargo centers, roads, commodities--were in process towards providing a complete transportation linkage from Malawi to the coastal port of Dar es Salaam.

The progress of the project elements financed by A.I.D. as of March 22, 1990 was as follows:

- . Construction of two port facilities at Chilumba and Chipoka and a ship repair facility at Monkey Bay were virtually complete. These facilities will be fully operational once (1) workshop tools are provided by the British Overseas Development Authority, (2) gantry cranes for Chipoka and Chilumba are delivered and installed, and (3) the slipway winches are installed at Monkey Bay.



Figure 1: Completed workshop at Monkey Bay

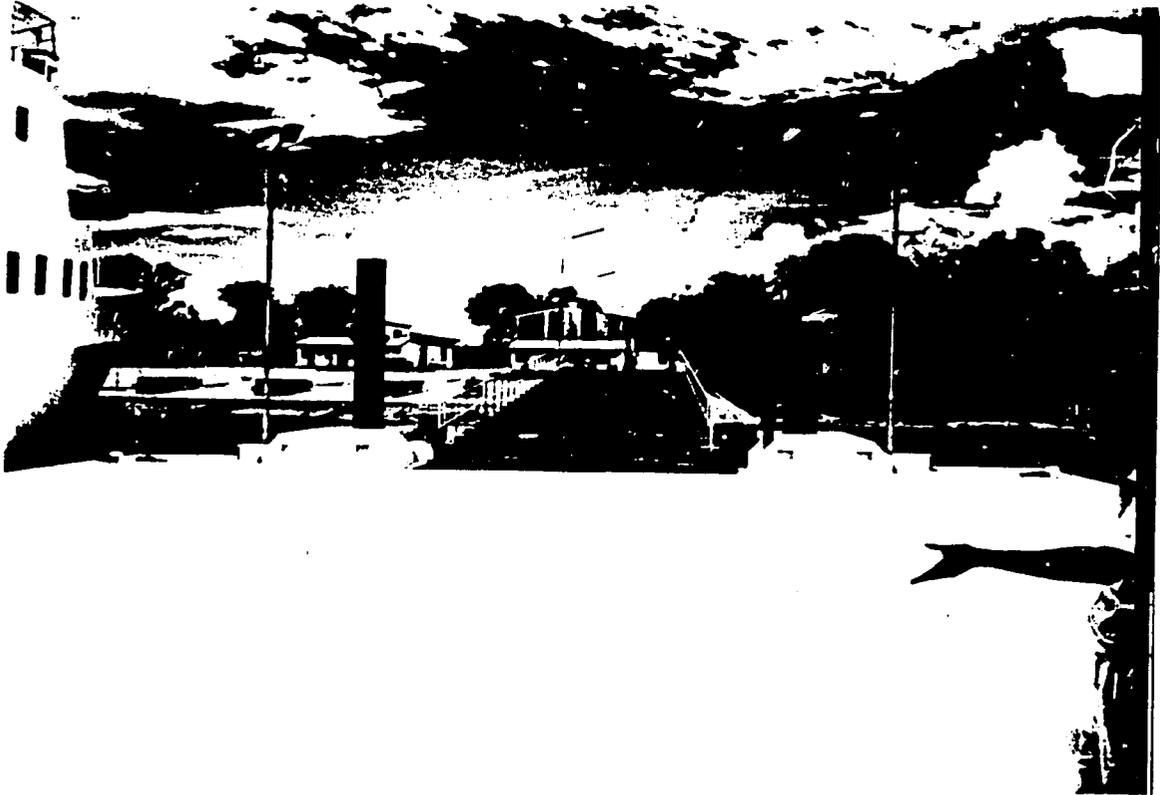


Figure 2: Pontoon (foreground) and bridge at Monkey Bay

Procurement of commodities has been delayed; however, the contracts for the commodities had been awarded, or in some cases were about to be awarded.

With the delivery and installation of these commodities, A.I.D.'s portion of the project will be complete. The planned completion date of June 30, 1991 is, in our opinion, a reasonable date for completion.

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Did USAID/Malawi and the GOM adequately plan for, and did USAID/Malawi appropriately finance, the procurement of construction services, commodities and materials; and were source and origin rules for procurement of goods followed?

For the items tested, we found that commodity needs were adequately identified and reviewed, and commodities and materials received were used for intended purposes. However, we found that the Mission did not appropriately finance construction, and purchases of materials and equipment were often from ineligible sources and origin.

A.I.D. obligated about \$10.8 million for the construction of port facilities at Chipoka, Chilumba, and Monkey Bay on Lake Malawi. All contracting for the construction services was performed by the host country, the GOM. The total amount obligated is evidenced by the Project Implementation Letter (PIL) agreements between USAID/Malawi and the GOM that "fixed" the amount reimbursable to the GOM (\$10.8 million). This amount was independent of the actual contracts that the GOM entered into with its construction firms. As of January 28, 1990, \$8.9 million had been advanced against the \$10.8 million obligated. Commodities, which were also to be procured by host country contracting, consisted of (1) gantry cranes at the Lake Malawi ports of Chipoka and Chilumba, and the port of Dar es Salaam in Tanzania; (2) slipway winches for the ship repair facility at Monkey Bay, (3) diesel generators for the Malawi Cargo Centers at Mbeya and Dar es Salaam in Tanzania, and (4) fuel tanktainers and railway tankers for fuel transport. Obligations for commodities totalled \$7.9 million, of which \$0.9 million had been advanced for that purpose as of the time of audit.

We found that (1) USAID/Malawi and the GOM had adequately reviewed, assessed, and identified construction services and materials and commodity needs, and (2) construction materials and commodities received were used for intended purposes. However, we found that the Mission inappropriately used the Fixed Amount Reimbursement (FAR) method of financing the construction component of the project. In addition, we found that rules requiring procurement of goods be from eligible countries as to source and origin were often not followed. Problems with FAR and ineligibly procured goods are discussed below.

#### **Use of FAR Was An Inappropriate Method Of Financing Construction**

The Fixed Amount Reimbursement (FAR) method of financing construction is to be used when there are a large number of similar construction activities and costs can be reliably estimated. Under these circumstances, A.I.D.'s reimbursements for completed construction can be fixed in advance based upon reliable cost estimates. USAID/Malawi, however, applied the FAR method even though (1) the project consisted of only three dissimilar, complex construction activities, and (2) construction cost estimates increased very rapidly and were highly uncertain. USAID/Malawi used the FAR method because it involved less intensive management on its part than alternative methods of financing construction, and because it wanted to get around host country contracting rules so as to allow Malawian firms to be eligible to bid for the contracts. Use of FAR may have increased construction costs. It also significantly reduced USAID/Malawi's involvement in the project and, in our opinion, contributed to breaches in source/origin rules

by the construction contractors and to excessive advances to the GOM for construction services. We, however, are not making a recommendation concerning FAR because the decision to use FAR was made by other than just USAID/Malawi officials. Nevertheless, we suggest that USAID/Malawi review its method of financing future projects to make sure the funding methods conform fully with A.I.D. criteria and are not used to avoid complying with A.I.D. rules on source/origin requirements.

**Purchases Using Foreign Exchange Were Made From Ineligible Sources and Origin**

The project agreement requires that materials and equipment purchased for or used in the construction of project facilities using foreign exchange have their source and origin in eligible countries. The GOM's construction contractor, however, purchased about \$2.6 million worth of materials and equipment from ineligible sources and origin without a waiver. This occurred because USAID/Malawi did not follow through with a system to ensure that the source and origin requirements were met as it did not believe they were totally applicable. As a result, manufacturers from eligible countries, including the U.S., were denied the opportunity to provide equipment and materials worth about \$2.6 million.

**Recommendation No. 1:** We recommend that the Mission Director, USAID/Malawi:

- 1.1 obtain a properly authorized source/origin waiver in accordance with A.I.D. waiver guidance for \$2.6 million.
- 1.2 issue a Mission Order prescribing the strict adherence to the source/origin rules during the remainder of this project and any other project currently underway, as well as for any future projects. This guidance should include timely reporting of non-compliance and, in that event, timely corrective actions to be taken--whether a waiver, refund, or bill of collection.

In accordance with the project agreement, the GOM contracted directly with certain firms for the construction of three shipping and repair facilities on Lake Malawi. USAID/Malawi provided the GOM the financing of these contracts. The GOM and its construction contractors set up special bank accounts to pay for equipment and materials used in construction. To facilitate payments made to offshore suppliers, USAID/Malawi agreed to make advance deposits to these accounts. Foreign exchange payments made to suppliers from these accounts for construction materials, equipment and services through December 31, 1989 totalled \$4,254,375.

For these goods to be eligible for A.I.D. financing, A.I.D.

Handbook 11 states that commodities and equipment procured by a contractor or subcontractor for incorporation into the project or use in performing an A.I.D.-financed contract must have their source and origin in eligible countries, unless specifically waived. In addition, the project agreement states that goods procured with foreign exchange must be from eligible countries. These requirements were again communicated, and agreed upon, through project implementation letters that USAID/Malawi used to give instructions to the GOM for procurement of goods for each port facility. Eligible countries were defined generally as the U.S. and other free world countries except Japan, developed countries in Western Europe and the Republic of South Africa.

The Mission recognized the need to provide a source/origin waiver for \$101,000 worth of fuel pumping equipment from ineligible countries which generally included Japan, developed countries in Western Europe and the Republic of South Africa. This was done during the design stage of the project. USAID/Malawi subsequently also recognized that a waiver would be required for purchases of \$995,000 worth of steel and additional fuel pumping equipment and instruments from ineligible countries. The Mission intended for the waiver to be effective with a Project Paper Supplement issued in February 1988. However, the proposed waiver lacked specificity and the regional legal office thereby refused to approve it. The Supplement was therefore issued without the waiver.

A May 1989 project evaluation reported that even though the goods had been in fact purchased from ineligible countries, a waiver to do so was never finalized by the Mission. Responding to the evaluation's recommendation, the Mission re-drafted and submitted the waiver, and it was finally cleared by the regional legal office in September 1989, after the fact.

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**\$2.6 million of materials and equipment were purchased from ineligible sources and origin.**

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Nevertheless, even after considering the above two waivers, we found that an additional \$2.6 million of the \$4,254,375 of purchases made from offshore suppliers with foreign exchange were from ineligible sources and origin, and were purchased without a waiver.

In arriving at the amount of \$2.6 million, we first sampled customs documents evidencing importation of the goods valued at \$4,254,375 that were on file at the office of the consulting engineer, Lahmeyer International. This sample showed that goods were predominantly from ineligible sources and origin. As our objective

was to determine the value of ineligible goods, and because of the very large volume of documents that would otherwise have been necessary to record information on all ineligible transactions, we recorded detailed information for eligible transactions only. These items were then valued at the amount shown on suppliers' proforma invoices and the offshore bank account activity statements. We then subtracted the value of these eligible goods, the value of authorized waivers, and the value of purchased services from \$4,254,375 to arrive at \$2.6 million (see Exhibit II).

The ineligible purchases included such items as heavy construction equipment, vehicles, mechanical equipment, office equipment, and various spare parts and construction materials. The majority of these goods were purchased from suppliers in Western Europe. For example: mechanical equipment was purchased from Meridian Trade Corp., Ltd. of the U.K. for \$200,663, a motor grader from Intra Corp., Ltd. of the U.K. for \$119,909, and Toyota vehicles and Caterpillar equipment from Kier International, Ltd. also of the U.K. for \$70,430 and \$66,174 respectively.

Purchases were made from ineligible sources and origin because the GOM did not include A.I.D. source and origin rules in their contracts with the construction contractors, and thereby did not require them to adhere to such rules. For that matter, it disregarded a requirement defined in the project agreement--goods purchased for the project using foreign exchange must have their source and origin in eligible countries. When we asked about this of an official of the GOM's implementing ministry, the Ministry of Works and Supplies, we were told that they were not aware of such a requirement. They also advised us that the A.I.D. procedures they needed to follow for contracting under the FAR method of financing were all new to them, and that the source and origin rules should have been brought to their attention before the contracts were executed. Instead, they said, the contracts were reviewed and approved by A.I.D. without the rules on source and origin included.

The project agreement requirement related to source and origin of goods were clearly stated: eligible countries. However, the Mission did not follow through with a system to ensure that the requirement was met by the GOM (and its contractors) because the Mission believed that, in at least certain cases, this requirement was not applicable--that host country contracts are not bound to the requirement because they were financed by the FAR method.

This has resulted in manufacturers and suppliers in eligible countries, including the U.S., not being given the opportunity to provide equipment and materials worth about \$2.6 million.

We consider the breach of source/origin rules to be a serious matter. A strict application of the rules would mean that the \$2.6 million of goods from ineligible sources and origins would not be

eligible for A.I.D. financing. However, as the GOM and its contractors were not solely at fault, we believe it would be unduly harsh to require the GOM to repay the funds after the fact. Therefore, we believe that USAID/Malawi should seek to waive the source/origin rules and take steps to ensure that non-compliance does not happen again with the remaining procurement for this project or any other, current or future.

### Management Comments and Our Evaluation

Although the Mission accepted recommendation No. 1 and intended to implement it, they generally stated that, because the construction was financed using the Fixed Amount Reimbursement (FAR) method, A.I.D. management was concerned primarily with outputs rather than inputs. Thus, they believed that inputs such as equipment need not conform to the source and origin procurement regulations. The Mission further cited a cable dated April 29, 1987 from the regional legal advisor that summarized implementation guidance for the construction that was to be financed using the FAR method. It stated that "Under FAR, A.I.D.'s source/origin...rules are not applicable".

We believe this guidance was erroneous in that it also implied that no A.I.D. rules were applicable. Furthermore, the cited cable also stated that "A.I.D.'s review of the draft contract is only for purposes of ensuring that the specifications for the construction are adequate and as agreed upon under the project." This contradicts the guidance that stated the source and origin rules were not applicable as it is impossible to abide by the grant agreement's requirements without applying source and origin rules.

Nevertheless, notwithstanding the audit's determination that the FAR method of financing was inappropriately used, the Inspector General Legal Counsel's opinion was that, despite any departure from ordinary source and origin regulations that FAR allows, the Mission chose to follow ordinary regulations by including Article 6 of the project agreement. That article states that procurement of goods requiring foreign exchange have their source and origin in eligible countries. That article also did not exempt from this requirement any specific category of goods, whether materials, equipment, or otherwise.

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### **Were Disbursements Made in Accordance with Applicable Laws and Regulations?**

For the items tested, we believe disbursements were made in accordance with applicable laws and regulations. However, we found that advances to the Government of Malawi (GOM) for construction services far exceeded the immediate cash needs of the recipients, and the host Government retained advances which were not required.

A.I.D. authorized \$19.1 million in life-of-project funding. Through March 7, 1988, A.I.D. had obligated the total project funds. At the time of the audit, we found that the obligated funds had been committed to the budget categories of the project agreement. As of January 28, 1990, total disbursements were \$9.8 million, most of which were advances for construction and procurement of commodities.

We found that (a) the obligated funds were properly used to fund authorized project activities, (b) cash balances were accurately recorded in the Mission records, (c) vouchers were properly recorded in commitment liquidation records and (d) related reports were prepared in accordance with applicable laws and regulations.

However, the Mission did not have proper oversight and proper data for determining whether cash advances exceeded the immediate disbursing needs of recipients. Consequently, the Mission gave the Government of Malawi advances to cover needs in excess of three months. Initial advances amounted to about \$5.6 million compared to construction contracts totalling about \$8.2 million. The excess advances resulted in excessive interest costs of about \$383,000. In addition, although A.I.D. agreed to make a Fixed Amount Reimbursement payment to the GOM of \$10.8 million in local currency, advances of about \$4.8 million were in dollars, much of which was used to purchase equipment and materials from ineligible sources.

**Excessive Advances Were Given to  
The GOM For Construction Services**

A.I.D. policy requires that advances be limited to the minimum amount needed for immediate disbursing needs. However, USAID/Malawi advanced the GOM funds in excess of immediate disbursement needs. This happened because USAID/Malawi gave an initial 20 percent mobilization advance that wasn't required to be liquidated before other advances were given. Also, cash requirement projections were overstated by GOM officials and USAID/Malawi did not review these requests for reasonableness. Consequently, the GOM retained very large advances in both local and offshore accounts, which resulted in excessive interest costs of about \$383,000. As of March 22, 1990, the GOM still retained unnecessary advances of \$501,403.

**Recommendation No. 2: We recommend that the Mission Director, USAID/Malawi:**

- 2.1 require the Government of Malawi to refund \$501,403 of unliquidated cash advances still unutilized as of March 22, 1990.
- 2.2 emphasize the Mission's system for monitoring advances to the host Government, including advances under the

**Fixed Amount Reimbursement Method of financing to ensure that they equate to actual need, and require that all outstanding advances be actively reviewed to conform to A.I.D. requirements.**

A.I.D. requires that cash advances be provided to recipients to meet their immediate disbursing needs. Handbook 1 states that cash advances be provided for as much as 30 days from the date the recipient receives the advance until it is expended. This period could be extended to 90 days if a properly approved written justification determined that implementation would be seriously impeded or interrupted by applying the 30-day rule.

The agreement between A.I.D. and the GOM required the host Government to contract for the construction of two shipment facilities and a ship repair facility on Lake Malawi. A.I.D. agreed to reimburse the GOM the equivalent of \$10.8 million in local currency for the construction. Accordingly, the GOM signed three construction contracts for the three facilities totalling \$8.2 million. In order to facilitate payments to the contractors, A.I.D. agreed to provide the GOM with advances. According to PIL numbers 4, 5 and 11:

- . a 20 percent initial advance of the contract amount was to be provided;
- . subsequent monthly advances were to be based on the amount of work estimated to be completed in the next 30 days; and
- . approval of subsequent advances was to be based upon progress verified by USAID/Malawi from inspection and contractors' certificates, reduced by contractors' retention (which was 10 percent).

Contrary to A.I.D.'s policy and the project agreement, USAID/Malawi provided the GOM construction advances which were in excess of 30 days' needs of the contractors--in fact, the advances were generally in excess of 90 days' requirements.

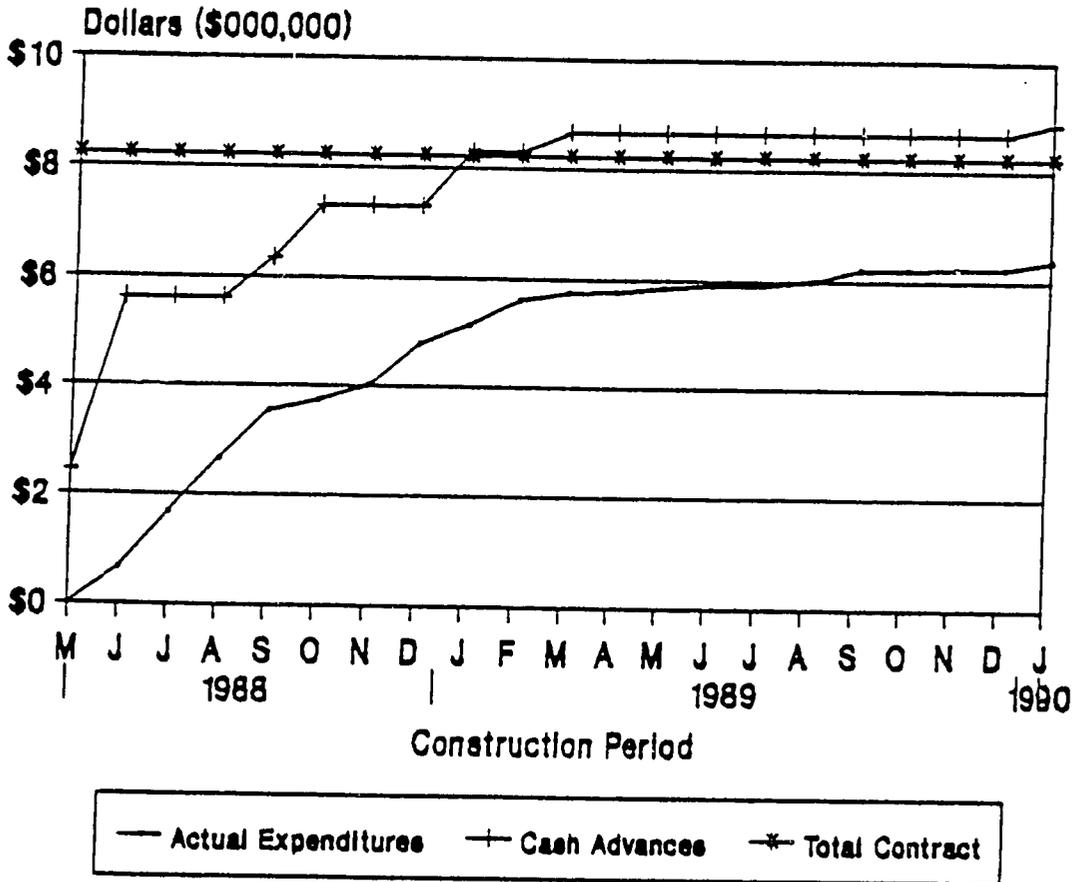
In accordance with the PILs, an initial advance of 20 percent of the contract amount would have totalled only \$1.6 million. However, \$5.6 million was advanced to the GOM as initial advances in May and June 1988. This amount was about 68 percent of total contract costs, and about \$4 million greater than the 20 percent authorized by the PILs. Further, while the initial advances of \$5.6 million were provided in May and June 1988, our analysis found that the contractors' actual expenditures were only \$0.7 million in the same period. Therefore, at the end of June 1988, the GOM had unutilized advances totalling \$4.9 million.

Moreover, it took as long as February 1989--or eight months after the original advance--for the contractors' cumulative expenditures

to finally reach what was initially advanced (\$5.6 million). In comparison, however, advances to the GOM by that time had increased to an accumulated total of \$8.3 million. In fact, by January 1989, USAID/Malawi had already advanced the GOM the total contractual amount (\$8.2 million), but had not withheld the 10 percent retention as required by the PILs.

The following diagram shows advances in relation to contractual reimbursable amounts and actual contractors' expenditures.

### MALAWI NORTHERN CORRIDOR PROJECT Excess Cash Advances



The total advances consisted of \$4.8 million advanced in dollars and the equivalent of \$4.1 million in local currency. These excessive advances were given to the GOM for the following reasons:

- . the GOM projected cash requirements and requested advances in excess of what was needed to pay the contractors;
- . the Mission did not properly review the GOM's and contractors' cash requests for propriety and conformity with agreements; and
- . the Mission provided subsequent advances before the GOM used the initial advances.

Our review found that the GOM requested advances in excess of amounts needed to pay the contractors. In addition, Mission officials did not dispute these requests. A review of payments made by the GOM would have shown that only \$1.6 million should have been provided as an initial advance to the GOM. This amount would have covered the initial 20 percent mobilization advance and expenditures for May and June 1988.

However, Mission officials stated that the Fixed Amount Reimbursement method of financing did not allow the Mission to be properly involved in project implementation. Therefore, the Mission accepted requests for advances from the GOM without knowing whether such advances would be required or not. In effect, the Mission's system established by Mission Order 807 of August 31, 1988 was not followed for advances because of the project's financing method--FAR.

The Mission officials also believed that the initial advances were supposed to be recovered over the life of the contracts. Therefore, they argued that subsequent advances were to be provided to the GOM without regard to the initial advance balances. Other advances were to be provided to the GOM based on projected needs by the GOM. However, this method was based on a formula that the GOM had devised--a formula that they stated was a standard one for them to use in their contracts with construction firms. But this formula did not reflect what USAID/Malawi and the GOM had actually agreed upon in the PILs.

In our opinion, the language in PIL number 4, 5 and 11 relating to advances were very clear in that (a) an initial 20 percent of the contract amount be provided to the GOM and (b) subsequent monthly advances be requested by the GOM on the basis of estimated work to be completed in the next 30-day period. The PILs did not mention that the initial advances were to be recovered throughout the construction period based on any specified recovery formula. These points were further supported by USAID/Malawi's Mission Order 807 dated August 31, 1988 which, in response to a prior audit

recommendation concerning the need to tighten controls over cash advances, required advances to be liquidated within 30 days. The Order also did not specify that "initial" advances such as mobilization advances would be excepted from this rule.

As a result of liberal advance procedures used, USAID/Malawi made total contract payments, in effect, to the contractors without ascertaining whether the construction was done according to A.I.D.'s technical specifications. Therefore, in the event there were any defects or incomplete construction, A.I.D. would have no leverage because the total contract amounts have already been given to the GOM. In addition, the GOM retained unused advances totalling \$1,066,444. This amount was comprised of \$565,041 provided for procurement from offshore suppliers and another \$501,403 in equivalent local currency. Nevertheless, the audit found that, to the Mission's credit, it had at least identified the excess advances of \$565,041 that were provided for offshore procurement. They requested this amount be returned to the U.S. Treasury and, in fact, the GOM refunded it in January 1990.

Although the Mission identified the excess advances for offshore procurement, the auditors noted that they were identified late in project implementation. In addition, USAID/Malawi still had not identified unused advances for the equivalent of \$501,403 which were for local currency procurement. This amount should also be returned as they are funds that the GOM does not need to pay its contractors. The amount is comprised of a \$269,871 initial advance unrecovered from the contractor at Monkey Bay, even though construction is virtually complete, and \$231,532 due from the GOM as of March 22, 1990.

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**The U.S. Treasury incurred excessive interest costs of about \$383,000.**

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In addition, as a result of these liberal advance procedures, the audit found that the U.S. Treasury incurred excessive interest costs of about \$383,000. This amount was calculated based on an average total excess advance of \$2,623,780 at a cost of 8 percent covering the period May 25, 1988 through March 22, 1990.

We believe that the Mission should request the GOM to refund the excess advances still being held pending final settlement of the reimbursement amounts. The Mission should also ensure that the system established to monitor and review cash advance needs (Mission Order 807) be followed, including for those made to the host Government under the Fixed Amount Reimbursement method of financing.

In response to a preliminary draft of this report, the Mission indicated that unutilized local currency advances remaining in the GOM accounts as of January 31, 1990 was the equivalent of \$196,448. The Mission also stated that this amount was already requested to be refunded in PIL number 26 dated March 26, 1990.

The auditors laud the Mission's responsive action taken to have unused advances refunded. However, the equivalent dollars requested should be \$501,403, as we have previously identified, not \$196,448. We have determined that the difference in these amounts is due to the following:

1. The Mission incorrectly used an exchange rate of Malawi Kwacha (MK) of MK 2.6 = US \$1 in converting all MK advances into dollars. We, on the other hand, have used the actual exchange rate that was in effect at the time an advance was given the GOM, in accordance with the Mission's method of accounting for local currency advances and FAR balances. In converting earnings (or re-payments) against these advances, we used an average rate of exchange for each of the three construction projects.
2. The Mission has not fully recovered all of the initial working capital advance for construction at Monkey Bay. As evidenced by the last interim certificate number 4, cumulative re-payments of working capital were MK 551,034.10. However, the initial working capital advanced was MK 1,208,790, leaving an unrecovered working capital balance of MK 657,755.90, or \$269,871.

Therefore, the equivalent dollars the Mission should be requesting as a refund from the GOM remains \$501,403.

#### Management Comments and Our Evaluation

In response to our draft report, the Mission contended that advances made to the GOM generally have been liquidated in a timely manner. It also stated that guidance provided by the regional legal advisor (Mission cited the same cable referenced on page 12) stated that rules for cash advances on FAR-financed contracts are not governed by A.I.D. regulations. Finally, the Mission believed that the auditors interpreted mobilization payments by the GOM to the contractors as advances made directly to those contractors.

However, review of the information contained in the above referenced cable (see page 35, Appendix II) reveals that the guidance provided related to contracting procedures, not cash advance procedures of A.I.D. Further, as evidenced by the Mission's project implementation letter (PIL) number 18 dated August 22, 1989, the Mission clearly appreciated the applicable

rules. In addition to reiterating procedures that were provided in PILs 4, 5, and 11, it stated that U.S. Treasury regulations require that amounts held by the GOM be, at most, the project's needs for 30 days. The PIL also required that the GOM provide the Mission with details of its anticipated 30 days immediate cash needs on a monthly basis, to include names of suppliers, descriptions of goods, due dates, and copies of invoices.

From all the factual evidence gathered and presented, we believe that cash advances were not liquidated in a timely manner.

Nevertheless, the Mission states it accepts our recommendation. Further, with reference to Recommendation No. 2.1, it advised that all unliquidated cash advances made to the GOM have been recovered.

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#### **Did the GOM Contribute Resources As Agreed?**

As of the time of the audit the GOM had contributed about three-fourths of the agreed contributions. However, although A.I.D. Handbook 3 requires missions to monitor host country contributions, USAID/Malawi had not established a system for tracking the GOM's contributions to the project. A system was not established because Mission officials believed that the GOM was not contractually bound to make contributions. Thus, until our audit was performed, the extent of the GOM's contributions to the project were unknown to the Mission.

**Recommendation No. 3:** We recommend that the Mission Director, USAID/Malawi design and implement a monitoring system for tracking GOM contributions and ensuring all contributions required are made by the project completion date.

According to the project agreement, the GOM agreed to make contributions of at least \$4 million. These contributions consist of design and consulting engineers' costs, personnel, and other contributions. The GOM's contributions to the project as of March 22, 1990 were about \$3.1 million, as determined by review of data provided by the GOM. Given the fact that there is still about a year until the project's completion, we believe it is reasonable to expect that the GOM could make additional contributions by project completion that will bring total contributions in excess of \$4 million. However, this is not assured.

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**A system was not in place to track the GOM's contributions.**

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A.I.D. Handbook 3 states that the Project Officer is responsible for the project's monitoring process. Such monitoring imposes upon the Project Officer the duty of overseeing all aspects of project implementation and, thus, the monitoring of all provisions of the project agreement--such as the provision for host country contributions.

However, we found that the project officer did not establish a monitoring system to ensure that the GOM complied with the project agreement. The Mission believed that monitoring was not required because the project was ESF-funded, exempting the GOM from making contributions. They also stated that the contribution requirement in the project agreement was probably only intended to commit the GOM to the project in "practice", not have it contractually bound to any specific amount. Thus, until this audit was performed, the Mission did not know the full extent of the GOM's contribution.

Using what the audit has established as total contributions as of March 22, 1990--\$3.1 million--as its starting point, the Mission should implement a monitoring system to track remaining contributions through to project completion.

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#### Were Environmental Concerns Adequately Resolved?

In implementing development assistance, A.I.D. policy requires that appropriate safeguards are adopted to protect the environment. However, as USAID/Malawi considered the issue low priority, it did not adequately pursue measures to safeguard Lake Malawi from pollution. Consequently, the project has in fact increased the risk of polluting the lake.

Recommendation No. 4: We recommend that the Director of USAID/Malawi work in conjunction with the Regional Environmental Office and the Government of Malawi to develop a plan that ensures that shipment of hazardous substances on the lake is regulated.

A.I.D. policy requires that environmental concerns are integrated into the design and decision-making process of all A.I.D.-funded projects. This was accomplished by the project designers, USAID/Zimbabwe, by (1) advising the GOM that an environmental assessment was required before the financing for the project can be approved, and (2) having the assessment performed by the regional environmental officer during the project's design in June 1986.

The assessment concluded that most project activities would have little or no significant impact on the lake environment. However, the regional environmental officer recognized that ships carrying diesel, petrol, paraffin jet fuel and other chemicals will be

traversing Lake Malawi in increasing numbers as a result of the project. Accordingly, he advised the Mission in his assessment that it should request the GOM to present legislation that ensures that restrictions on transport of hazardous substances apply to lake traffic, and can be enforced. However, this recommendation was not followed by the Mission as it wasn't considered to be a high priority project issue. Yet it was necessary to follow through to discourage environmentally harmful activities on the lake. It is also A.I.D. policy to assist developing countries to formulate regulation through bilateral policy dialogue.

But the issue had been effectively dropped. In fact it was not until the mid-term evaluation performed in May 1989 that the pollution control issue was brought up as one that needed to be addressed. The evaluation's recommendation was a restatement of the recommendation made in the original environmental assessment. The evaluation was subsequently forwarded to the GOM in August 1989 asking them for their comments. The GOM responded finally in December 1989, but merely commented that:

**"The issue of pollution control on Lake Malawi deserves full investigation. We suggest that Mozambique and Tanzania should also be involved in any solutions to the problem".**

Such a response by the GOM, although recognizing potential lake pollution to be a serious problem, falls well short of addressing the original environmental assessment request--ensuring that legislation exists that places restrictions on shipping of hazardous materials.

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**The project has increased the risk of polluting Lake Malawi.**

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We interviewed the GOM official who authored the response to the evaluation report. He reiterated and acknowledged the fact that the environmental concerns had to be addressed. However, he also stated that to his knowledge no action or communication on the issue had taken place to or from his government and other possibly interested governments, including USAID/Malawi, since the issuance of the December 1989 letter. In addition, he admitted that there were no specific plans for the future to address the issue.

On the other hand, merely forwarding a copy of the evaluation report and asking the GOM for their comments did not exhibit any firm initiative on the Mission's part to pursue the environmental

issue to be in compliance with: (1) A.I.D. policy, (2) the original environmental assessment, and (3) the mid-term evaluation.

As a result of inaction by both the Mission and the GOM, the project has increased the risk of polluting Lake Malawi--one of the largest lakes on the African Continent and ninth largest in the world.

During the course of our detailed audit review in March 1990, we were advised by USAID/Malawi that it plans to have the new regional environmental officer from Nairobi, Kenya come to Malawi to lend assistance to the Ministry of Transport and other interested government organizations regarding pollution control on the lake.

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**REPORT ON  
INTERNAL CONTROLS**

We have audited USAID/Malawi's Northern Corridor Project (Southern Africa Regional) for the period July 24, 1986 through March 22, 1990 and have issued our report thereon dated October 29, 1990.

We conducted our audit in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to fairly, objectively, and reliably answer the objectives of the audit. Those standards also require that we:

- . assess the applicable internal controls when necessary to satisfy the audit objectives; and
- . report on the controls assessed, the scope of our work and any significant weaknesses found during the audit.

In planning and performing the audit we considered A.I.D.'s internal control structure to determine our auditing procedures in order to answer the audit objectives and not to provide assurance on the internal control structure.

The management of A.I.D., including USAID/Malawi, is responsible for establishing and maintaining adequate internal controls.

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**Audit Objective One**

The first audit objective involved gathering and verifying information on the progress of the project. The sources of the information included the 1988 evaluation report, USAID/Malawi and GOM progress and trip reports, implementation committee meeting reports, and interviews.

We noted the following reportable condition:

- . A Fixed Amount Reimbursement system of financing was used which removed project management and oversight from the officials (as discussed on page 8).

This deficiency resulted in the use of project funds to procure commodities from ineligible sources/origin (see internal control objective two).

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**Audit Objective Two**

This audit objective involved gathering information on whether USAID/Malawi and the GOM had adequate controls over procurement of commodities, construction equipment and materials. The sources of the information included interviews with pertinent USAID/Malawi, GOM, and contractor officials; and the examination of their supporting documents.

We noted the following reportable internal control condition:

- . USAID/Malawi did not have proper controls to ensure that funds were used for the procurement of goods from authorized sources and origin (see page 9).

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**Audit Objective Three**

This objective relates to the Mission's accounting for A.I.D. funds. In planning and performing our audit, we considered the applicable control policies and procedures in A.I.D. Handbook 1, 19, and the Controller's Handbook. For the purposes of this report, we classified the relevant policies and procedures into: the accounting system, the disbursement process, and the reporting process.

We noted the following reportable conditions:

- . the Mission authorized a reimbursement method--Fixed Amount Reimbursement--which did not provide good control over use of project funds;
- . the Mission advanced the GOM funds to the extent of total contract amounts even though final completion certifications had not yet been received; and
- . the Mission did not properly review advance requests for their propriety.

As a result of the above conditions, the contractors made procurement from ineligible sources and origin, and the U.S. Government incurred excessive interest costs because of excessive advances to the GOM (see discussion beginning on Page 13).

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**Audit Objective Four**

This audit objective relates to GOM's contribution to the project. The sources of the information included interviews with GOM officials, USAID/Malawi officials, and review of pertinent documents.

We noted the following reportable condition:

the Mission did not have a monitoring system in place for determining what the GOM contributed to the project (see Page 19).

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#### **Audit Objective Five**

This audit objective relates to the environmental impacts of the project. We reviewed issues raised by the design paper and the project evaluation on the environmental impacts of the project, conducted interviews with USAID/Malawi and GOM officials, and reviewed pertinent documents.

We noted the following reportable condition:

The Mission did not adequately follow through with an environmental recommendation made during the time of the project's evaluation design, as well as in a mid-term project evaluation. The action required was to determine that the GOM presented legislation that ensures restriction on the transportation of hazardous substances on Lake Malawi, and that such legislation was enforced (see Page 21).

Consequently, the project has increased the risk of polluting Lake Malawi.

Our consideration of internal controls would not necessarily disclose all matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable conditions described under audit objectives numbered one, two, three, and four are material weaknesses.

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**REPORT ON  
COMPLIANCE**

We have audited USAID/Malawi's Northern Corridor Project (Southern Africa Regional) for the period July 24, 1986 through March 22, 1990 and have issued our report thereon dated October 29, 1990.

We conducted our audit in accordance with generally accepted government auditing standards, which require that we plan our audit and perform the audit to fairly, objectively and reliably answer the audit objectives. Those standards also require that we:

- . assess compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives (which includes designing the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives), and
- . report all significant instances of noncompliance and abuse and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

The results of our tests of compliance disclosed the following significant instances of non-compliance:

- . Audit Objective No. 2 - the GOM did not procure project commodities from eligible sources and origins as required by the grant agreement (see page 9 of this report).
- . Audit Objective No. 3 - USAID/Malawi did not properly monitor cash advances to the Government of Malawi as is required by AID regulations (see page 13).

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, USAID/Malawi, contractors, and the Government of Malawi complied, in all significant respects, with the provisions referred to in this report. With respect to items not tested, nothing came to our attention that caused us to believe that USAID/Malawi, contractors, and the Government of Malawi had not complied, in all significant respects, with those provisions.

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**MANAGEMENT COMMENTS  
AND OUR EVALUATION**

USAID/Malawi accepted all recommendations in the draft report and stated it intends to implement them in a timely manner. The Mission suggested that other action offices be included in draft report Recommendation No. 1 which was deleted from the final report. With reference to Recommendation No. 2.1, management stated that all unliquidated cash advances made to the GOM have been recovered. However, as the Mission did not positively identify the recovered amount as \$501,403 in their response to the draft report, Recommendation No. 2.1 is considered unresolved. It will be resolved once management agrees with that amount or provides documentation showing that a different amount was due at the time of recovery. All other recommendations are considered resolved.

USAID/Malawi disagreed with certain elements in two of the four findings. The Mission's comments and our evaluations are presented at the end of each of these findings on pages 12 and 18. For a complete copy of the Mission's comments, see Appendix II.

In general, the Mission's statements were based upon implementation guidance provided by regional offices in Nairobi. However, the auditors believe that Mission officials have unjustifiably departed from following A.I.D. rules and regulations, or adhering to requirements of the grant agreement and its own Mission Order. This was due to the Mission's general notion that less intensive management was required on their part because of their applying the Fixed Amount Reimbursement method of financing a major component of the project--a financing method that we considered inappropriate.

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FINANCIAL STATUS AS OF  
JANUARY 28, 1990

<u>INPUTS</u>	<u>PLANNED FUNDS</u>	<u>OBLIGATIONS</u>	<u>ADVANCES/ ACCRUED EXPENDITURES</u>	<u>UNEXPENDED BALANCE</u>
<u>Host Country Construction</u>				
Chipoka Port	\$ 2,916,155	\$ 2,916,155	\$2,597,792	\$ 318,363
Chilumba Port	4,548,322	4,548,322	3,686,426	861,896
Monkey Bay Shipyard	<u>3,287,583</u>	<u>3,287,583</u>	<u>2,572,218</u>	<u>715,365</u>
Sub-Total	<u>\$10,752,060</u>	<u>\$10,752,060</u>	<u>\$8,856,436</u>	<u>\$1,895,624</u>
<u>Commodity Procurement</u>				
Winches	\$ 245,000	\$ 245,000	\$ 196,000 <sup>1/</sup>	\$ 49,000
Gantry Cranes-Malawi	3,562,500	3,562,500	712,500 <sup>1/</sup>	2,850,000
Diesel Generators	393,418	393,418	- <sup>2/</sup>	393,418
Other Commodities	<u>3,733,382</u>	<u>3,733,382</u>	<u>- <sup>2/</sup></u>	<u>3,733,382</u>
Sub-Total	<u>\$ 7,934,300</u>	<u>\$ 7,934,300</u>	<u>\$ 908,500</u>	<u>\$7,025,800</u>
Management	182,000	182,000	19,100	162,900
Contingencies	<u>259,640</u>	<u>259,640</u>	<u>-</u>	<u>259,640</u>
Grand Total	<u>\$19,128,000</u>	<u>\$19,128,000</u>	<u>\$9,784,036</u>	<u>\$9,343,964</u>

1/ These amounts present initial mobilization payments to suppliers as agreed in the Requests for Payment (RFP).

2/ Contracts for diesel generators, gantry cranes for Tanzania, tank wagons and tank containers had not been awarded as of the time of audit.

## EXHIBIT II

AMOUNT OF INELIGIBLE CONSTRUCTION MATERIALS AND  
EQUIPMENT PURCHASED WITH FOREIGN EXCHANGE  
AS OF DECEMBER 31, 1989

	<u>PORT FACILITY</u>			<u>Total</u>
	<u>Monkey Bay</u>	<u>Chipoka</u>	<u>Chilumba</u>	
Total Foreign Exchange Payments To Offshore Suppliers	\$1,258,548	\$1,261,578	\$1,734,249	\$4,254,375
Less Authorized Waivers:				
In Project Paper	0	101,000	0	101,000
September 1989	535,000	220,000	240,000	995,000
Less Goods Otherwise Eligible	13,480	219,048	245,231	477,759
Less Purchased Services <sup>1/</sup>	<u>61,000</u>	<u>0</u>	<u>0</u>	<u>61,000</u>
Total Ineligible Goods	<u>\$649,068</u>	<u>\$721,530</u>	<u>\$1,249,018</u>	<u>\$2,619,616</u>

<sup>1/</sup> As opposed to goods, the audit did not determine the eligibility as to source and origin for services.

<b>SCOPE AND METHODOLOGY</b>
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**Scope**

We audited USAID/Malawi's Northern Corridor Project (Southern Africa Regional) in accordance with generally accepted government auditing standards. We conducted the audit from January 29, 1990 through March 22, 1990. We conducted our work in the offices of USAID/Malawi, at the GOM offices and at the offices of construction consultants. We also visited two of the three construction sites at Lake Malawi. In addition, audit interviews were held with REDSO/ESA officials.

The audit covered \$10.8 million provided to the GOM for construction purposes and reviewed the need for \$7.9 million earmarked for procurement purposes. The audit established whether commodities were procured from eligible sources and whether advances were given in accordance with laws and regulations. In addition, we reviewed the GOM's contribution to the project by analyzing lists of contributions made. Our review of environmental concerns was limited to review of actions taken to address issues raised by the design paper and the evaluation of the project.

The audit objectives did not cover the following areas:

- . The audit did not include an in-depth examination of the construction contracts award process because USAID agreed to a fixed amount reimbursement to the GOM, regardless of the cost the GOM was to incur.
- . The audit did not determine whether procurement of \$7.7 million worth of commodities (the non-construction input component) met the source and origin requirements, and whether these commodities met the required specifications. These commodities had yet to be procured and delivered as of the time of the audit.
- . Finally, the audit did not review the contractors' and GOM's charges against the project for propriety and allowability. A FAR system of financing was used which committed A.I.D. funds to the extent of \$10.8 million regardless of the amounts incurred by the GOM for construction.

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## **Methodology**

The methodology for each audit objective follows:

### **Audit Objective One**

The first audit objective consisted of establishing the status of the project. We reviewed and verified findings of a 1989 evaluation of the project. We also examined consultant engineers' reports, USAID/Malawi officials' trip reports, the Regional Engineers' trip reports, and records evidencing coordination with other donors. In addition, in order to assess the progress of the project, we visited and inspected two of the three construction sites. The funding for these two sites is \$6.2 million of the \$10.8 million total planned for construction. Our work did not cover that portion of the project that is financed by other donors. Therefore, we cannot attest to the implications and impacts of other donors' inputs to the overall objective of the Northern Corridor Project.

### **Audit Objective Two**

In order to accomplish audit objective two we determined whether: (1) commodity needs and specifications were adequately reviewed and identified, (2) commodities purchased were from eligible sources and origin, and (3) commodities received were used for intended purposes. We examined the project paper's commodity specifications and the procurement plan, waivers, invoices, and bank payments to offshore suppliers. We also reviewed site inspection reports, consultants' reports, customs records and construction contracts specifications. We also interviewed officials of USAID/Malawi, the host government and consulting engineers.

### **Audit Objective Three**

To accomplish the third audit objective we determined whether (1) funds were used for authorized activities, (2) cash advances exceeded immediate disbursing needs and were liquidated in an expeditious manner, (3) cash balances were accurately recorded in the Mission accounts, (4) financial data was adequate for monitoring financial implementation of the project to comply with financial reporting requirements required by laws and regulations, and (5) required reports were prepared on a timely basis.

We examined the project agreement and amendments, the PILs, the funds control ledgers, cash advance summaries, and contractors'

progress completion certificates. In addition, we analyzed advances in relation to expenditures incurred, and reviewed public vouchers authorizing advances. This analysis covered the entire universe of \$10.8 million earmarked for construction purposes. We performed tests on other supporting documents and reports to establish whether such documents and reports complied with requirements of the project agreement.

#### **Audit Objective Four**

The fourth audit objective consisted of establishing whether the host government made necessary contributions to the Northern Corridor Project. To accomplish this objective, we examined whether (1) the Mission was monitoring government contributions, (2) in-kind contributions were properly and accurately converted to their dollar equivalent, and (3) the amount of contributions were at least what the GOM agreed to in the project agreement.

To accomplish the audit objective, we also (1) interviewed Mission officials on the monitoring system used to establish the host government contributions, (2) reviewed the GOM's statement of contributions and judgmental sampled items for appropriateness and accuracy, (3) reviewed exchange rates used in converting local currency contributions to dollars and examined the lists of contributions for accuracy and completeness, (4) reviewed the project agreement and the A.I.D. Handbooks on required contributions by the host government, and (5) discussed with GOM officials how they quantified contributions made.

#### **Audit Objective Five**

Audit objective five related to determining whether environmental impacts of the project were properly addressed. In order to accomplish this objective, we compared environmental recommendations defined in the project paper and project evaluation to actions taken as determined by (1) discussions held with USAID/Malawi officials, (2) interviewing several GOM officials, and (3) examination of pertinent correspondence.

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**RECEIVED**

14 SEP 1990

**RIG/A/N****MEMORANDUM**

Date: September 13, 1990

To: Toby Jarmon, RIG/A/Nairobi

From: *Carol Peasley*  
Carol A. Peasley, Director, USAID/Malawi

Subject: Draft Audit Report of Southern Africa Regional Malawi  
Northern Corridor Project (690-0237)

Attached are USAID/Malawi's comments on the subject report for inclusion in the final report. We appreciate that you have made substantive changes to the earlier draft, that you have identified some areas where corrective action is required, and that you have crafted the recommendations in such a way as to both highlight key factors as well as define actions which the Mission can implement without delay and undue difficulty. As you will note, our comments concern more the findings and supporting arguments, rather than the recommendations.

Finally, please note that the project title which appears in your memo and in the audit report is incorrect. The correct title is, Malawi Northern Corridor Project (Southern Africa Regional).

**AUDIT REPORT OF MALAWI NORTHERN CORRIDOR PROJECT  
(SOUTHERN AFRICA REGIONAL, 690-0237):**

**USAID/MALAWI COMMENTS**

USAID/Malawi accepts all recommendations in the audit report, and intends to implement those recommendations in a timely fashion. The audit report has identified areas where corrective action is required, and generally has included recommendations which both highlight key factors as well as define actions which the Mission can implement without undue difficulty.

While accepting the report recommendations, the Mission has the following comments on individual report findings:

1. "The use of FAR was an inappropriate method of financing construction." The audit team decided that this "finding should be addressed to the office responsible for project implementation, USAID/Malawi." The report ignores the fact that the decision to use FAR was, at the time, a well-documented design decision, one included in the Project Paper which was authorized by USAID/Zimbabwe (which has responsibility for the Southern Africa Regional Program) and cleared by all appropriate technical and legal offices. While USAID/Malawi had a role in making the final decision, it was not a determining role. For both the finding and the resulting Recommendation No. 1 to have its intended impact, we recommend that RIG address the finding and recommendation to a broader audience.

2. "Purchases using foreign exchange were made from ineligible sources and origin." The report states, "We consider the breach of source/origin rules to be a serious matter." USAID/Malawi also considers any breach of source/origin rules to be a serious matter, and any suggestion that the Mission would think otherwise is unfounded. What the report is referring to are purchases of construction equipment and material made by the contractors during execution of the FAR contracts. While the Mission has agreed that purchases of material should be covered by A.I.D. procurement regulations, the Mission did not believe that construction equipment, purchased within a FAR contract, would be so covered. This interpretation was supported by previous and current regional engineers associated with the project, all of whom have had prior experience with FAR contracts. Despite what the report contends, no project documents intended to apply A.I.D. regulations to the procurement of construction equipment.

In addition, the report states, "[The Ministry of Works] said [that] the contracts were reviewed and approved by A.I.D. without the rules on source and origin included." In accordance with guidance from the Mission's Regional Legal Advisor (RLA), the Mission did no review of

the terms and conditions of the FAR contracts. Given the importance the auditors place on this matter, it is useful to quote relevant sections of a cable from the RLA (Nairobi 14880, dated April 29, 1987). It is important to note that no reference to this guidance appears in the audit report.

RLA believes that there is a basic misunderstanding on the part of GITEC [the design contractor], and perhaps Government of Malawi (GOM), on the method of A.I.D. financing for these construction works. As planned and discussed in the PP, the construction elements will be financed by A.I.D. through the fixed amount reimbursement (FAR) method. This method requires much less A.I.D. involvement in the contracting process, compared to host country contracting, as detailed below.

Because A.I.D. is reimbursing GOM for outputs, rather than actually funding the contract A.I.D.'s review of the draft contract is only for purposes of ensuring that the specifications for the construction are adequate and as agreed upon under the project. Because this is a technical review, the role of the A.I.D. SARP engineer is critical at this stage; RLA review is not usually involved.

Under FAR, A.I.D.'s source/origin and competition rules are not applicable; the host country follows its own usual procedures and A.I.D. does not approve the various steps in the contracting process, except for approval of the specifications as noted above, and engineering inspection of the works as the construction progresses.

Because of the above principles, RLA finds that all references to A.I.D. in the draft conditions of contract submitted by GITEC must be deleted, as well as all A.I.D.-specific clauses.

It should be apparent from the above reference that the Mission closely followed RLA guidance concerning all aspects of FAR construction contracting.

3. "Excessive advances were given to the GOM for construction services." The Mission holds by its position that advances made to the GOM generally have been liquidated in a timely fashion by the GOM. The auditors interpret mobilization payments made by the GOM to the FAR construction contractors as advances made directly by USAID to those contractors. In essence, this is to say that the terms of FAR contracts are governed by A.I.D. regulations. As noted above, this is not in accordance with RLA guidance provided to the Mission. What is necessary in this instance is a determination by AID/W as to whether RLA guidance or the auditors' interpretation is correct. We have seen no indication that this kind of determination has been requested. To summarize the Mission's position, USAID has made advances to the GOM, which in turn has used those advances to execute the FAR contracts. Once the GOM has liquidated the USAID advance through payments to the

contractors, additional advances have been considered. The Mission agrees that a minor problem was encountered at one time with the GOM in terms of liquidation of advances made to the GOM, but this problem was rectified as quickly as possible. With reference to Recommendation No. 3.1, all unliquidated cash advances made to the GOM have been recovered.

The Mission has no further comments on the audit report.

Auditor's Note: Recommendation 3.1 in the draft report  
(and as referenced above) is Recommendation No. 2.1  
in the final report.

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