Regional Inspector General for Audit
Nairobi, Kenya

Audit of USAID/Madagascar Sector Assistance Programs Program Nos. 687-0101 and 687-0102

Report No. 3-687-92-01
October 25, 1991

INSPECTOR GENERAL
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID/Madagascar followed A.I.D. procedures to ensure that policy reforms were met before funds were released to the Government of Madagascar and that local currency was deposited into special accounts. However, some local currency was not deposited and A.I.D. policies and procedures were not followed to ensure that all local currency was deposited into interest-bearing accounts and programmed and spent in a timely manner.

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

UNITED STATES POSTAL ADDRESS
BOX 232
APO N.Y. 09675

INTERNATIONAL POSTAL ADDRESS
POST OFFICE BOX 30261
NAIROBI, KENYA

October 25, 1991

MEMORANDUM

TO	:	Director, USAID/Madagascar
FROM	:	Toby L. Jarman, RIG/A/Nairobi Toby L. Jarman
SUBJECT	:	Audit of USAID/Madagascar Sector Assistance Programs, Program Nos. 687-0101 and 687-0102

Enclosed are five copies of our audit report. In preparing this report, we reviewed your comments on the draft report and included them as an appendix to this report. Recommendation No. 1.1 includes $118,000 in local currency arrears which need to be deposited into the special account. Recommendation No. 2.1 includes $10.2 million which is presently idle and needs to be programmed and spent. If these funds are not disbursed within one year, we estimated that the Government of Madagascar will lose the equivalent of $1.8 million in purchasing power due to inflation. Recommendation No. 3 proposes placing certain funds in interest bearing accounts which could generate an estimated $397,000 in interest earnings over the next year.

Recommendations 1.1, 2.1 and 3 are unresolved and will be resolved when we obtain your agreement on the specific dollar and Malagasy Franc amounts connected with these recommendations. The remaining recommendations in the report are resolved and will be closed when appropriate actions are completed. Please respond to this report within 30 days indicating any actions planned or already taken to implement the recommendations.

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

EXECUTIVE SUMMARY

Started in April 1985 and August 1988, respectively, the Madagascar Agricultural Rehabilitation Support Project (MARS) and the Madagascar Agricultural Export Liberalization Program (MAELP) were designed to support the efforts of the Government of the Democratic Republic of Madagascar in liberalizing its agricultural policy by providing (1) needed foreign exchange through a Commodity Import Program and a policy reform-conditioned cash transfer program and (2) project grants for technical assistance, training and studies to acquire information related to policy reform.

To achieve its objectives, A.I.D. authorized $14.2 million in life-of-project funding for MARS and $31.3 for MAELP, all of which had been obligated as of December 1990.

Between January 15 and February 27, 1991, we audited the programs in accordance with generally accepted government auditing standards (see page 2 and Appendix I) and found the following:

- USAID/Madagascar followed A.I.D. procedures to ensure that conditions precedent in the grant agreement were met before funds were released to the Government of Madagascar (see page 5).

- USAID/Madagascar followed A.I.D. policies and procedures to ensure that local currency was deposited into the special account, except for the local currency equivalent of $118,000 that had not been deposited into the MARS special account as required by the grant agreement (see page 9).

- USAID/Madagascar did not follow A.I.D. policies and procedures to ensure that local currency funds were programmed. As a result, the equivalent of $27.2 million was unspent in the MARS and MAELP special accounts and $10.2 million of this amount which included arrears to the MARS account was unprogrammed (see page 11).

- USAID/Madagascar did not take action to have all local currency placed in interest-bearing accounts, as recommended by current A.I.D. policy. As a result, the local currency equivalent of $6.1 million relating to the MARS project was held in a non-interest bearing account which we project could earn the equivalent of $397,000 over the next year if placed in an interest bearing account (see page 14).

The report contains three recommendations. The first recommends that USAID/Madagascar issue a Mission Order to improve its monitoring of local currency to ensure that arrears are collected and that future local currency deposits are made in a timely manner. The second recommends that USAID/Madagascar develops plans to ensure that local currency from the two programs, and future projects, are programmed and spent in a timely manner. The third recommends that USAID/Madagascar make a formal proposal to the Government of Madagascar to place the MARS local currency funds in an interest bearing account. The report also (1) presents our assessment of internal controls (see page 16) and (2) reports on USAID/Madagascar's compliance with applicable regulations (see page 19).

A draft report was issued to USAID/Madagascar Management and copied to the Regional Economic Development Services Office for East and Southern Africa (REDSO/ESA) for comments. USAID/Madagascar concurred with the findings and recommendations. REDSO/ESA also supported the findings but expressed concern that implementation of the recommendations could be slow in the current Malagasy political climate. Further, REDSO/ESA stated that the report confirmed the need for future designs to minimize the need to manage local currencies.

Office of the Inspector General

Office of the Inspector General
October 25, 1991

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INTRODUCTION

Background

The A.I.D. Madagascar Agricultural Rehabilitation Support Project (MARS) and the Madagascar Agricultural Export Liberalization Program (MAELP) were intended to support the Government of the Democratic Republic of Madagascar ("the Government") in its efforts to liberalize its agricultural sector.

MARS was started in April 1985 and was scheduled to end in September 1991. The authorized life-of-project funding was $14.2 million, all of which was obligated as of December 1990. Of this amount, $12.1 million was to be used in a commodity import program under which A.I.D. provided the foreign exchange required by the Government to import various commodities needed to increase agricultural production. As of March 31, 1991, $11.6 million had been provided under this component.

MAELP was started in July 1988 and was scheduled to end in June 1991. Its purpose was to support the Government in removing existing policy and procedural barriers to external markets in order to increase exports and the production of export crops. The authorized life-of-project funding was $31.3 million, all of which had been obligated as of December 1990. Of this amount, $28.6 million was provided to the Government in the form of policy reform-conditioned dollar disbursements.

Both MARS and MAELP also had technical assistance components for which $2.1 million and $2.7 million, respectively, had been obligated as of December 1991. These components were used to assist the Government in performing studies for the purpose of gathering and analyzing data needed to formulate agricultural policy.

The local currency proceeds generated from both the commodity import program under MARS and the dollar disbursements under MAELP were to be deposited into special accounts and spent for development purposes mutually agreed upon between the Government and USAID/Madagascar.

Responsibility for monitoring these programs has changed since their inception. Before

September 1990 the Regional Economic Development Officer for East and Southern Africa (REDSO/ESA) and an A.I.D. Representative Office in Madagascar were responsible for reviewing these programs. In September 1990 USAID/Madagascar attained full Mission status and became primarily responsible for monitoring the programs.

Audit Objectives

The Office of the Regional Inspector General for Audit/Nairobi audited the two USAID Madagascar Sector Assistance Programs to answer the following audit objectives:

1. Did USAID/Madagascar follow A.I.D procedures to ensure that conditions precedent in the grant agreement were met before funds were released to the Government of Madagascar?

2. Did USAID/Madagascar follow A.I.D. policies and procedures to ensure that (a) correct amounts of local currency were deposited into the special accounts (b) local currency funds were programmed and spent in a timely manner, and (c) local currency was deposited in interest bearing accounts?

In answering these audit objectives, we tested whether USAID/Madagascar, which received support from REDSO/ESA (1) followed applicable internal control procedures and (2) complied with A.I.D. policy and certain provisions of the grant agreement. Our tests were sufficient to provide reasonable - but not absolute - assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. However, because of limited time and resources, we did not continue testing when we found that, for the items tested, USAID/Madagascar followed A.I.D. procedures and complied with legal requirements. Therefore, we limited our conclusions concerning these positive findings to the items actually tested. But when we found problems areas, we performed additional work to:

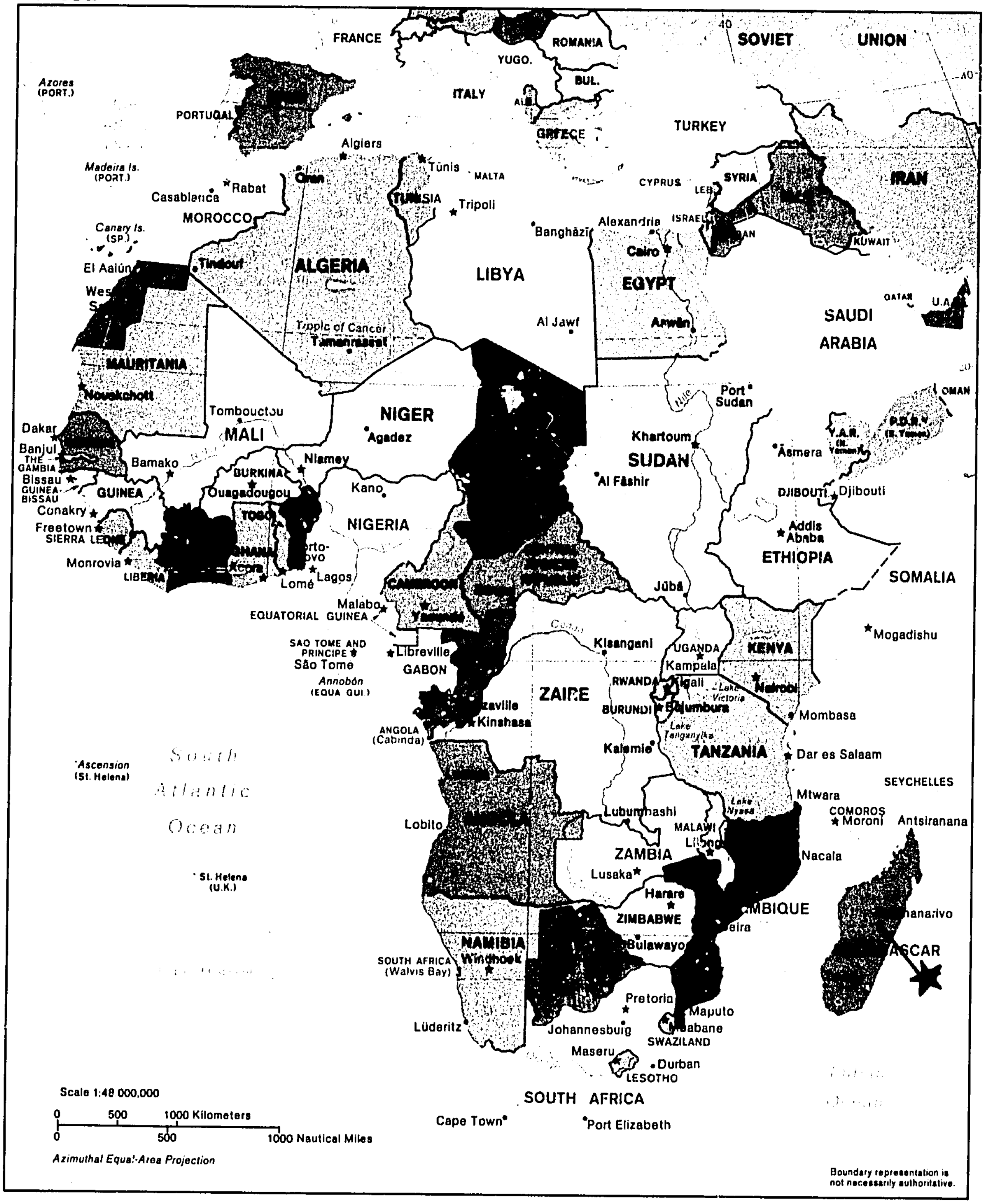
- conclusively determine that USAID/Madagascar was not following a procedure or not complying with a legal requirement,

- identify the causes and effects of the problems and,

- make recommendations to correct the conditions and causes of the problems.

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

Africa



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REPORT OF AUDIT FINDINGS

Did USAID/Madagascar follow A.I.D procedures to ensure that conditions precedent in the grant agreement were met before funds were released to the Government of Madagascar?

In our opinion, USAID/Madagascar followed A.I.D. procedures to ensure that conditions precedent in the Madagascar Agricultural Export Liberalization Program (MAELP) grant agreement were met before funds were released to the Government of Madagascar ("the Government"). We did not answer this objective for the Madagascar Agricultural Rehabilitation Support (MARS) program because it did not include cash transfers contingent on policy reform. Instead, studies, seminars and training relating to the planning of policy reform were conducted under MARS to provide a basis upon which future policy reforms could be formulated and implemented.

As discussed below, of the $28.6 million in MAELP cash transfers made by A.I.D., the conditions precedent specified in the grant agreement and Project Implementation Letters (PILs) were met before funds were released to the Government of Madagascar.

A.I.D. Handbook 4, Chapter 8 states that A.I.D. must have evidence that all conditions precedent, for disbursing funds under a cash transfer agreement, have been met and the date they were met before funds are released to the cooperating country. The Handbook further states that for non-project assistance agreements conducted in the field, the required information and advice of execution of the agreement may be in the form of cables from the Mission.

Under MAELP, the grant agreement, amendments to the grant agreement and PILs specified, in detail, the governmental policy changes and economic agricultural export targets that were required as conditions precedent before funds could be transferred to the Government. These conditions precedent were intended to promote liberalized agricultural export market operations and to allocate foreign exchange in an open market.

USAID/Madagascar followed A.I.D. procedures to ensure that the conditions precedent were met before funds were released to the Government. Cash transfers totalling $28.6 million were made to the Government in four tranches between December 1988 and December 1990 in accordance with A.I.D. procedures, the terms specified in the Grant Agreement and the PILs. This was done after personnel from USAID/Madagascar and the Regional Economic Development Services Office for East and Southern Africa (REDSO/ESA) reviewed, analyzed, confirmed and documented evidence which showed that all the required policy reforms and export targets were met. The most significant of these reforms and targets included:

-- opening the export market for traditional export crops (coffee, cloves and pepper) to the private sector;

-- increasing the share of traditional export crops marketed by the private sector to at least 50 percent of the total value for at least two of these crops;

-- reducing the fees, administrative approvals and time required to process an export shipment;

-- initiating a system to allocate foreign exchange in an open market;

-- reducing the tariff disincentives associated with the export of cloves and coffee;

-- changing export tax regulations so that the same payment modalities of export taxes are applied to all exporters; and

-- establishing an agricultural market information system for the benefit of producers and exporters.

The evidence gathered, analyzed and documented for the above conditions precedents included:

-- the texts of three Government decrees which liberalized the export marketing of export crops -- effectively opening the export of crops to the private sector;

-- statistical information for 1988 which showed that the private sector was responsible for 53 percent and 68 percent of the value of pepper and clove exports, respectively;

-- the text of a Government decree - corroborated by interviews with exporters - which reduced the administrative steps, fees and time to process an export shipment;

-- the contents of the official Government notices and technical guide for use by Malagasy banks which established a system to allocate foreign exchange in an open manner;

-- the texts of a finance law and decree which reduced taxes and their related disincentives associated with the export of cloves and coffee;

-- a Government decree which eliminated different modalities for the payment of export taxes for different types of exporters; and

-- copies of the agricultural market information reports published and distributed by the Government.

A complete listing of the conditions precedent and the evidence gathered, analyzed and documented for the most significant conditions precedent for the four cash transfers made is shown in Appendix III.

In compliance with A.I.D. Handbook 4 procedures, USAID/Madagascar obtained this evidence and confirmed to AID/W by cables, that all conditions precedent were met. In addition, USAID/Madagascar also supplied AID/W with other required documentation including a statement of the date the conditions precedent were met, the dollar amount to be disbursed, the bank address, account name and number to which the funds were to be sent.

As a result of the evidence gathered and the analyses performed by USAID/Madagascar and REDSO/ESA supporting that the required targets and policy reforms were met, we concluded that A.I.D. transferred $28.6 million in accordance with A.I.D. procedures.

Did USAID/Madagascar follow A.I.D. policies and procedures to ensure that (a) correct amounts of local currency were deposited into the special accounts (b) local currency funds were programmed and spent in a timely manner, and (c) local currency was deposited in interest-bearing accounts?

For the items tested under MAELP and according to the information contained in the September 1991 Price Waterhouse non-Federal audit report (3-687-91-11-N) for MARS, USAID/Madagascar followed A.I.D. policies and procedures to ensure that local currency was deposited into special accounts. However, certain weaknesses arose in USAID/Madagascar's procedures which allowed some local currency to remain undeposited. Also, the Mission did not follow A.I.D. procedures to ensure that local currency funds were programmed and spent in a timely manner. USAID/Madagascar followed A.I.D. policies and procedures for depositing funds in the special accounts at the time the MAELP and

MARS grant agreements were signed. However, because of an October 1987 change in A.I.D. policy which recommended that funds be placed in an interest bearing account, USAID/Madagascar was not following this current A.I.D. policy for the MARS project.

According to an analysis of the MAELP special account prepared by the Government in November 1990 and the Bank'ny Tantsaha Mpamokatra statement of this account, which the auditors obtained and compared to the Government's analysis, all local currency deposits under MAELP had been made to an interest-bearing special account as required in the grant agreement. Through December 1990, deposits to the MAELP local currency account from A.I.D. cash transfers including interest totalled approximately Malagasy Francs (FMG) 34.7 billion ($21.6 million). To ensure these deposits were made, USAID/Madagascar obtained, reviewed and monitored Government of Madagascar analyses of the MAELP special account. USAID/Madagascar reviewed this special account to ensure that all deposits were made and that the available funds were earning interest.

According to the Price Waterhouse report, local currency totaling FMG 12.7 billion ($7.9) was deposited into the MARS non-interest-bearing special account as of May 1991. This comprised the bulk of the local currency due to the MARS special account. In order to achieve this, the office of the A.I.D. Representative and REDSO/ESA, in consultation with the Government of Madagascar developed procedures in 1985 requiring the Government to send debit notes to the importers for all imports made. Also, under the grant agreement, the government had responsibility to ensure that deposits were made for all imports before the goods were received by importers. Through periodic visits to the Government and the importers, REDSO/ESA Commodity Management officials reviewed the status of deposits and reported any problems noted to USAID/Madagascar management.

Based on our review of both the Price Waterhouse report and USAID/Madagascar's monitoring procedures, USAID/Madagascar followed A.I.D. policies and procedures to ensure that local currency amounts were deposited into the special account. However, certain weaknesses in these monitoring procedures allowed FMG 120 million ($118,000) out of total funds of FMG 12.8 billion ($8.0 million) to remain undeposited. Of the FMG 47.4 billion ($29.5 million)[1] deposited into the MAELP and MARS local currency accounts, FMG 31.2 billion ($19.4 million) was programmed and FMG 3.7 billion ($2.3 million was spent. Based on our review of the Price Waterhouse report for MARS and the MAELP

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[1]Except where otherwise noted in the report, the U.S. dollar equivalents of the local currency FMG amounts were converted at the exchange rate in effect as of February 15, 1991 (FMG 1,609 to $1.00). The equivalent dollar amounts are provided only to give the reader an indication of the dollar significance of the actual FMG activity and balances.

local currency account analysis, USAID/Madagascar did not follow A.I.D. policies and procedures to ensure that local currency funds were programmed and spent in a timely manner - for both MARS and MAELP. FMG 16.2 billion ($10.1 million) was unprogrammed and FMG 43.7 billion ($27.2 million) was unspent. The undeposited local currency in the MARS account, the unprogrammed and unspent funds for MARS and MAELP, and the MARS funds not held in an interest bearing account are discussed in the following sections.

Local Currency Deposits Were in Arrears

The grant agreement for MARS required local currency generations to be deposited in a special account, and A.I.D. guidance on local currency strongly emphasized that special accounts must be carefully monitored by missions. However, not all MARS local currency generations were deposited as required because of procedural oversights by the Government of Madagascar and certain weaknesses in USAID/Madagascar's and REDSO/ESA's monitoring procedures. As a result, local currency generations of FMG 120 million ($118,000) had not been deposited into the MARS special account.

Recommendation No. 1

We recommend that the Director, USAID/Madagascar issue a Mission Order which incorporates procedures to improve the Mission's monitoring of local currency to ensure that:

1.1 importers deposit FMG 120 million ($118,000) of local currency arrears as of May 1991, and any subsequent arrears, to the Madagascar Agricultural Rehabilitation Support Project's special account; and

1.2 correct amounts are deposited into the special account in a timely manner for all ongoing and future projects which generate local currency.

The MARS grant agreement specified that local currency must be deposited into the special account, in a sum equivalent to the dollar value of the imports made under the commodity import program. To ensure these deposits were made, the Office of the A.I.D. Representative, Madagascar and REDSO/ESA developed procedures with the Government in 1985, whereby the latter invoiced the importers for the commodities imported under the program. The procedures required importers to make the deposits in full before the goods were cleared through customs. Further, A.I.D.'s October 1987 Supplemental Guidance to Policy Determination Paper No. 5 on local currency strongly emphasized the policy that special accounts must be monitored by missions.

According to a recent Price Waterhouse audit report, approximately FMG 12.7 billion ($7.9 million) was deposited in the MARS special account as required by the grant agreement. However, as of May 1991, FMG 120 million ($118,000) had not been deposited, all of which was outstanding for more than two years.

According to the Price Waterhouse report, these arrears occurred because the Government did not collect FMG 44 million ($29,000) for invoices it issued to importers in 1989 and because the Government did not issue invoices for FMG 76 million ($89,000) worth of goods imported in 1987. While USAID/Madagascar followed A.I.D. policies and procedures for ensuring most local currency deposits were made, USAID/Madagascar and REDSO/ESA did not monitor whether the Government of Madagascar followed established procedures for the deposit of all local currency. For example, while USAID/Madagascar was receiving the "Bank Centrale de Madagascar" statements for the MARS account, it was not comparing the deposits shown on this statement with invoices submitted by the Government to the importers.

...USAID/Madagascar and REDSO/ESA did not monitor whether the Government of Madagascar followed established procedures...

According to USAID/Madagascar management, the absence of an effective monitoring system was due to the evolution of the responsibility for monitoring the MARS program from REDSO/ESA and an A.I.D. Representative office in Madagascar to a fully staffed Mission over a 5 year period. Until USAID/Madagascar was established as a "Class A" Mission in September 1990 (one with at least seven U.S. direct hires including a core staff comprising a Director, Program Officer, Project Development Officer, and adequate financial and technical staff), there were limited resources available to monitor the MARS local currency account. For example, from 1985 to June 1989 there were only two US direct hires and two local national employees to oversee all project activities. As a result, for monitoring MARS, USAID/Madagascar relied heavily on the brief quarterly visits made to Madagascar by a REDSO/ESA commodity management officer. It was not until June 1989 that additional staff began arriving in Madagascar, and it was not until more than one year later in September 1990 that A.I.D.'s office in Madagascar was staffed to a level of 37 U.S. and foreign service nationals.

The current USAID/Madagascar management realized the problem with local currency and reported this weakness to the Assistant Administrator in its latest internal control assessment dated November 10, 1990. The assessment proposed addressing these problems through a non-Federal audit of MARS which was carried out by Price Waterhouse between October 1990 and May 1991.

As a result of the arrears due to the MARS account, FMG 120 million ($118,000) was not available to be spent for development purposes in Madagascar. Furthermore, although USAID/Madagascar had procedures for monitoring the MAELP local currency deposits which were made as required, it was not receiving the bank statements for the MAELP account, and as a result, could not ensure the accuracy of the activity and balances in the account as reported by the Government. USAID/Madagascar's monitoring of local currency deposits could be further strengthened if it were to receive bank statements on a periodic basis, compare the bank statements to the account analysis prepared by and received from the Government, and reconcile these two items with the dollar value as paid by A.I.D./W.

Thus, based on the foregoing, we concluded that USAID/Madagascar needed to issue a Mission Order incorporating procedures to improve the Mission's monitoring of local currency deposits to ensure that (1) importers deposit FMG 120 million ($118,000) in local currency arrearages, and (2) the required local currency deposits for all ongoing and future projects are deposited.

Funds Needed To Be
<u>Programmed and Spent</u>

A.I.D. policy is to disburse local currency as quickly as possible, and a MAELP project implementation letter required funds to be jointly programmed by USAID/Madagascar and the Government of Madagascar within 30 days of cash transfers being made. However, as of May 1991, funds were unprogrammed and unspent in the MARS and MAELP accounts. This occurred because USAID/Madagascar was unable to jointly program these funds within the Government's budget which was constrained by International Monetary Fund (IMF) imposed ceilings on overall government spending. As a result, if unspent and/or unprogrammed funds are not disbursed within one year, we estimate that the Government will lose FMG 2.8 billion ($1.8 million) in purchasing power due to inflation.

<u>Recommendation No. 2</u>: **We recommend that the Director, USAID/Madagascar develop plans to ensure that:**

2.1 unprogrammed local currency from the two projects, (including arrearages to the Madagascar Agricultural Rehabilitation Support Project special account) totalling FMG 16.3 billion ($10.2 million) is disbursed in a timely manner; and

2.2 the design of future local currency generating projects will provide reasonable

assurance that funds are programmed and spent in a timely manner.

A.I.D. Policy as stated in the Supplemental Guidance on Programming Local Currency dated October 1987 requires that local currency generated from commodity import programs and cash transfers be disbursed as quickly as possible, consistent with sound programming and prevailing economic conditions. This policy paper further stated that funds should be spent as quickly as possible to minimize the net inflationary or deflationary effects. In addition, MAELP PIL No. 5 dated October 10, 1989 stated that the Government should submit a letter to USAID/Madagascar no later than 30 days after funds are transferred from A.I.D. to the Government, which specifies the elements of the Government's current and capital budgets in which these funds will be used.

From March 1986 to December 1990, approximately FMG 47.4 billion ($29.5 million) was deposited into the MARS and MAELP local currency accounts. However, approximately FMG 43.7 billion ($27.2 million) was not disbursed, of which FMG 16.2 billion ($10.1 million) was unprogrammed. In addition, MARS local currency arrears of FMG 120 million ($118,000), discussed in the previous section, when deposited would bring the total amount of unprogrammed funds to FMG 16.3 billion ($10.2 million).

A breakdown of the unspent and unprogrammed amounts in the two accounts follows. FMG 33.9 billion ($21 million) was unspent in the MAELP account, and according to the Price Waterhouse report, FMG 9.8 billion ($6.1 million) was unspent in the MARS account. FMG 7 billion ($4.4 million) was unprogrammed in the MAELP account and FMG 9.1 billion ($5.7 million) was unprogrammed in the MARS account. FMG 120 million ($118,000) in arrears to the MARS account also needed to be programmed when deposited.

...USAID/Madagascar had not been successful in getting the Government to program and quickly spend the funds...

Mission officials stated that the problem with unprogrammed and unspent funds occurred because the IMF established ceilings for overall government spending and the Government's spending priorities in non-project areas forestalled the spending of the local currency funds. Under these circumstances the Government spent much of its funds on its administrative costs, thereby limiting the funds that could be used for project related activities. Furthermore, USAID/Madagascar considered the programming and spending of counterpart funds more as additions to, rather than revenues to be considered part of, the Government's budget. Because of this, USAID/Madagascar had not been successful in getting the Government to program and quickly spend the funds for development purposes as stated in the grant agreement and recommended by A.I.D. policy.

At the time of the audit in February 1991, USAID/Madagascar had raised the issue with the Government in an attempt to have the local currency programmed and spent more quickly. Further, USAID/Madagascar officials stated they were planning to work with REDSO/ESA and the Government to establish procedures to program and spend local currency for current and future projects. The Deputy Director REDSO/ESA stated that this approach would include reaching agreement with the Government on programming or reprogramming and spending of local currency in agreed-upon areas within the budget where funds could be quickly disbursed.

The problem of unprogrammed and unspent funds was addressed in the Mission's latest internal control assessment to the Assistant Administrator dated November 10, 1990. USAID/Madagascar proposed addressing the problems regarding local currency by requesting a non-Federal audit of the MARS program, which was carried out by Price Waterhouse, under the supervision of the Regional Inspector General for Audit, Nairobi between October 1990 and May 1991.

As a result of IMF spending targets, Government spending priorities and the lack of success in jointly programming local currency funds, approximately FMG 43.7 billion ($27.2 million) was unspent in the MARS and MAELP accounts as of May 1991. Assuming a continuation of Madagascar's 1990 inflation rate of 11.5 percent - net of an assumed 6.5 percent interest earnings on the MAELP account - the purchasing power of this unspent amount will depreciate by FMG 2.82 billion ($1.8 million) in one year. Of this total loss in purchasing power, FMG 1.42 billion ($883,000) will result from the programmed (but not used) portion of the funds and FMG 1.40 billion ($872,000) from the unprogrammed portion. Also, the MARS portion of the unspent funds totalling approximately FMG 9.8 billion ($6.1 million) was not held in an interest bearing account which would help offset this erosion. The MARS funds that are held in a non-interest bearing account are discussed in the following section.

Furthermore, as of February 1991, USAID/Madagascar was planning future projects which according to its officials, could generate the local currency equivalent of approximately $35 million. Thus, unless this problem is resolved, local currency generated from these additional projects could significantly increase the amount of unprogrammed and unspent funds.

Based on the foregoing, we concluded that USAID/Madagascar needed to establish a plan to program and more quickly disburse local currency, (including arrears to the MARS special account) totalling approximately FMG 16.3 billion ($10.2 million). Additionally, in designing future projects, USAID/Madagascar needed to establish a plan to ensure that all local currency will be programmed and spent in a timely manner.

Not all Funds Were Placed in an Interest-Bearing Account

Current A.I.D. policy recommends placing local currency in interest bearing accounts. However, while MAELP funds were in an interest-bearing account, MARS local currency was not. MARS funds were not in an interest-bearing account because A.I.D. policy and the MARS grant agreement did not require placing funds in an interest bearing account at the time the project began. Approximately FMG 639 million ($397,000) could be earned in the next year if the MARS local currency balance as of May 1991 was placed in an interest-bearing account as recommended in current A.I.D. policy.

Recommendation No. 3

We recommend that the Director, USAID/Madagascar make a formal proposal to the Government of Madagascar to place the Madagascar Agricultural Rehabilitation Support Project local currency funds in an interest bearing account, and take the necessary action to transfer these funds to an interest bearing account if this proposal is accepted.

A.I.D. Supplemental Guidance to Policy Determination Paper No. 5, dated October 21, 1987, recommended that local currency be placed in interest bearing accounts. The MAELP grant agreement, dated July 29, 1988, required that local currency generated from this program be placed in an interest bearing account.

As of December 1990, approximately FMG 33.9 billion ($21 million) in MAELP funds were in an interest bearing account. Since the MAELP program began, approximately FMG 823 million ($512,000) was earned in interest. However, according to the Price Waterhouse report, MARS local currency totalling approximately FMG 9.8 billion ($6.1 million) was held in a non-interest bearing account as of May 1991.

The MARS local currency was held in a non-interest bearing account because at the time the MARS grant agreement was signed in April 1985, A.I.D. policy did not clearly require the use of interest bearing accounts, and as a result, such a provision was not included in the grant agreement. However, USAID/Madagascar was aware of A.I.D.'s policy concerning the use of interest bearing accounts beginning in October 1987, as evidenced by the fact that the MAELP grant agreement, which was signed after this policy became effective, required MAELP funds to be placed in an interest bearing account. Management officials also stated that this policy would be applied on all future projects as a matter of course. Nevertheless, since current A.I.D.-policy encourages funds to be placed in interest bearing accounts wherever possible, we believe the feasibility of transferring MARS funds to an interest bearing account should be explored with the Government.

..interest earned from such accounts would provide additional funds for development purposes.

If the funds had been placed in an interest bearing account at an estimated interest rate of 6.5 per cent account between January 1988 and December 1990, FMG 1.5 billion ($1.2 million) in interest could have been earned and could have been available for development purposes. If funds are placed in an interest bearing account, the May 1991 MARS local currency account balance would earn approximately FMG 639 million ($397,000), assuming this amount is held on deposit for one year at a 6.5 percent rate of interest. Thus, the interest earned from such accounts would provide additional funds for development purposes. Given the situation with unprogrammed and unspent local currency at the time of our audit, we believe it is possible for these funds to remain in the account for an extended period.

Thus, based on the above, we concluded that USAID/Madagascar should make a formal proposal to the Government to transfer MARS local currency funds to an interest bearing account.

Issues Needing Further Study

REDSO/ESA's comments to our draft report mentioned that a REDSO/ESA economist had discovered that the Government of Madagascar had established a "parallel overdraft account to the MAELP account" and that the Ministry of Finance had actually made a "loan" against it through an overdraft and used the funds for general revenue. The issue of the Government of Madagascar's banking arrangements and other bank accounts was clearly outside the scope of our audit. We were unable to obtain a clarification or additional information regarding this "parallel overdraft account" because the REDSO/ESA economist familiar with this issue was on home leave and thus unavailable. After discussing this issue with the REDSO/ESA economist upon his return, we plan to follow-up this matter with USAID/Madagascar. We will also advise the Regional Inspector General for Investigations, Nairobi and/or the Inspector General's Office of Legal Counsel in Washington, D.C., as appropriate.

REPORT ON INTERNAL CONTROLS

The section provides a summary of our assessment of internal controls for the audit objectives.

Scope of Our Internal Control Assessment

We conducted our audit in accordance with generally accepted government auditing standards which require that we plan and perform the audit work 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 our audit, we considered USAID/Madagascar's internal control structure to determine our auditing procedures in order to answer the audit objectives and not to provide assurance on its overall internal control structure.

For the purpose of this report, we have classified significant internal control policies and procedures applicable to the audit objectives by categories. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether they had been placed in operation--and we assessed control risk. We have reported these categories as well as any significant weaknesses under the applicable section heading for each objective.

General Background on Internal Controls

The management of A.I.D., including USAID/Madagascar, is responsible for establishing and maintaining adequate internal controls. Recognizing the need to re-emphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Manager's Financial Integrity Act (the Integrity Act) in September 1982. This Act, which amends the Accounting and Auditing Act of 1950, makes the heads of executive agencies and other managers as delegated legally responsible for establishing and maintaining adequate internal controls. Also, the General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining such controls.

In response to the Integrity Act, the Office of Management and Budget (OMB) has issued guidelines for the "Evaluation and Improvement of Reporting on Internal Control Systems in the Federal Government." According to these guidelines, management is required to assess the expected benefits versus related costs of internal control policies and procedures. The objectives of internal control policies and procedures for federal foreign assistance programs are to provide management with reasonable--but not absolute--assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether a system will work in the future is risky because (1) changes in conditions may require additional procedures or (2) the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusions for Audit Objective One

The first audit objective was to determine whether USAID/Madagascar followed A.I.D. procedures to ensure that conditions precedent were me before funds were released to the Government. For this objective, we have classified policies and procedures into the monitoring and documentation processes for ensuring that the conditions precedent relating to policy changes and export targets required in the grant agreements were met before funds were transferred from A.I.D. to the Government. We reviewed USAID/Madagascar's internal controls relating to the two processes and our tests showed that the controls were logically and consistently applied. Therefore, we limited our tests to reviewing information and documentation received and prepared by USAID/Madagascar before funds were released to the Government.

Conclusions for Audit Objective Two

The secon udit objective was to determine whether USAID/Madagascar followed A.I.D. policies and procedures for ensuring the timely deposit of local currency, the timely programming and spending of those deposits and the maintaining of local currency in interest-bearing accounts. In planning and performing our audit, we considered the applicable internal control policies and procedures developed by the Office of the A.I.D. Representative in Madagascar regarding deposit of local currencies, and those cited in A.I.D. Policy Determination Paper No. 5, and its supplement, the grant agreements and project implementation letters regarding the deposits, programming and spending of local currency. For the purpose of this report, we have classified policies and procedures into the (1) local currency deposit process, including the placing of funds in interest-bearing accounts and (2) joint programming and spending processes.

We reviewed USAID/Madagascar's internal controls relating to the two processes. On the local currency deposit process, our assessment showed that control procedures to ensure that local currency deposits were made in a timely manner for the Madagascar Agricultural Rehabilitation Project (MARS) were logically designed and consistently applied except that some local currency funds had not been deposited into the MARS project special account. Therefore, the non-Federal auditors carried out more extensive tests in order to quantify the amount in arrears. Regarding the joint programming and spending process, we could not rely on USAID/Madagascar controls. As a result, we expanded our tests to determine the amounts of unprogrammed and unspent local currency funds in the two projects that were reviewed. The problem of undeposited, unprogrammed and unspent local currency had been included in the USAID/Madagascar's reporting under the Integrity Act. Regarding depositing local currency funds in interest-bearing accounts, we found that USAID/Madagascar controls were reliable except for MARS funds which were not placed in an interest bearing account as recommended in current A.I.D. policy. As a result we expanded our audit work to determine the amount of interest that would be earned by maintaining these funds in an interest bearing account.

REPORT ON COMPLIANCE

This section summarizes our conclusions on USAID/Madagascar's compliance with applicable regulations.

Scope of our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards, which require that we plan 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.

We tested USAID/Madagascar's compliance with the terms of the grant agreement as they could affect our audit objectives. However, our objective was not to provide an opinion on USAID/Madagascar's overall compliance with such provisions.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grants and binding policies and procedures governing an organization's conduct. Noncompliance constitutes an illegal act when the source of the requirement not followed or prohibition violated is a statute or implementing regulation, including intentional and unintentional noncompliance and criminal acts. Not following internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition and is included in our report on internal controls. Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the letter of the laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with the grant agreement, laws and the regulations is the overall responsibility of USAID/Madagascar's management. As part of fairly, objectively and reliably answering the audit objectives, we performed tests of USAID/Madagascar's compliance with them.

Conclusion on Compliance

The results of our tests of compliance indicated that, with respect to the items tested, USAID/Madagascar complied with the requirements of the grant agreement except in one instance:

- USAID/Madagascar along with the Government of Madagascar did not ensure that local currency generated under the Madagascar Agricultural Export Liberalization Program (MAELP) was jointly programmed within 30 days after the deposits were made to the special accounts, as required by MAELP Project Implementation Letter No. 5 (see page 11).

MANAGEMENT COMMENTS AND OUR EVALUATION

USAID/Madagascar believes the discussions and findings in the audit report are clear and the recommendations are reasonable. USAID/Madagascar suggested some minor rewording, which we have incorporated into this final report as appropriate. In addition, USAID/Madagascar stated that it will take immediate steps to implement and close the recommendations.

REDSO/ESA supported the audit findings and stated that the report confirmed the need for future designs to minimize the need to manage local currencies. However, REDSO/ESA is concerned that the current political environment in Madagascar will hamper the implementation of the audit recommendations. In addition, REDSO/ESA mentioned that a REDSO/ESA economist had discovered that the Government of Madagascar had established a "parallel overdraft account to the MAELP account".

Based on the above, RIG/A/N considers Recommendation Nos. 1.2 and 2.2 resolved. These recommendations can be closed when this office receives documentary evidence that the recommended procedures, plans and proposals have been finalized.

Recommendations 1.1, 2.1 and 3 are unresolved and will be considered resolved when USAID/Madagascar and this office agree on the specific Malagasy Franc and equivalent dollar amounts connected with these recommendations. After the FMG and equivalent dollar amounts are agreed to, these recommendations can be resolved. They can be closed when this office receives documentary evidence that the procedures and plans implementing these recommendations have been finalized.

This office is following-up on the "parallel overdraft account" issue which is discussed in the Issues Needing Further Study Section of our report.

SCOPE AND METHODOLOGY

Scope

We performed a functional audit in accordance with generally accepted Government Auditing Standards. In addition, we utilized the Price Waterhouse (PW) audit work and report of the Madagascar Agricultural Rehabilitation Support (MARS) project Commodity Import Program component which was conducted in accordance with generally accepted government auditing standards under our supervision. We carried out the audit from January 15, 1991 through February 27, 1991 and covered those two currently active programs at that time - the MARS project and the Madagascar Agricultural Export Liberalization Program (MAELP) - that involved policy reforms and local currency generations.

For Audit Objective One, we tested 100 percent of the four MAELP cash transfers totalling \$28.6 million. As explained on pages 5 and 23 we did not perform any work under this audit objective for the MARS project. For Audit Objective Two, we examined and tested 100 percent of the MAELP local currency deposits due as of December 1990 which amounted to \$21 million. We also reviewed all expenditures under MAELP which amounted to \$508,000. We relied on the non-Federal audit of the MARS project conducted by PW. Of the MARS total deposits of \$7.9 million and total expenditures of \$1.8 million, Price Waterhouse reviewed all the deposits and \$0.5 million in expenditures. As a result, we did not test or independently examine MARS local currency deposits or expenditures.

We conducted our fieldwork in the office of USAID/Madagascar located in Antananarivo, Madagascar and in the offices of the Regional Economic Development Services Office, East and Southern Africa (REDSO/ESA) and the Regional Financial Management Center (RFMC) located in Nairobi, Kenya. We also held discussions with officials of the International Monetary Fund and the Government of Madagascar located in Antananarivo, Madagascar. To assure ourselves that we could rely on the work of Price Waterhouse and that their audit was conducted in accordance with generally accepted government auditing standards we reviewed PW's audit procedures and workpapers at their offices in Nairobi, Kenya. Based on our quality control review of PW's workpapers and draft report, we concluded that their work was performed in accordance with generally accepted government auditing standards and that we could therefore rely on the information contained in their report.

The audit was limited to reviews of (1) the Price Waterhouse report sections that related to MARS local currency deposits, programming and expenditures, (2) weaknesses in USAID/Madagascar systems that allowed the problems identified in the PW report to occur, (3) MAELP policy reforms, and (4) MAELP cash transfers, local currency deposits, programming and spending. The scope of our audit did not cover the following areas:

- testing the validity of the evidence gathered by USAID/Madagascar which supported their conclusion that all conditions precedent were met;
- testing MARS local currency deposits, programming or expenditures identified in the Price Waterhouse report; and
- discussing with or reviewing the records of importers and commodity end-users.

Methodology

The methodology for each audit objective follows:

<u>Audit Objective One</u>

The first audit objective consisted of gathering and analyzing information and documentation to determine whether USAID/Madagascar had evidence that all policy reforms and economic targets were met before cash transfers were made to the Government. We tested $28.6 million - 100 percent - of the four MAELP cash transfers to verify that all A.I.D. procedures were followed and that USAID/Madagascar obtained evidence to show that conditions precedent were satisfied before the cash transfers were made. To determine if the MAELP cash transfers were made in accordance with A.I.D. procedures we examined the evidence and documentation gathered and prepared by USAID/Madagascar and REDSO/ESA to show that conditions precedent were met. This evidence consisted of Government laws, regulations, decrees, economic reports, statistics, studies and agricultural information bulletins. As MARS did not include cash transfer contingent on policy reforms, we did not perform any audit work to answer this objective.

Audit Objective Two

To accomplish our second audit objective we determined whether USAID/Madagascar followed A.I.D. policies and procedures to ensure that the correct amount of local currency was deposited and that local currency was programmed and spent in a timely manner. To make these determinations, we (1) reviewed the Price Waterhouse report and identified those significant findings that related to our audit objectives, (2) investigated the weaknesses in USAID/Madagascar's controls that allowed the problems identified in the Price Waterhouse report to arise, (3) examined the MAELP account analyses, bank statements and supporting documentation for local currency deposits and expenditures, (4) compared A.I.D. cash transfers for MAELP with account analyses and banks statements, (5) compared MAELP analyses of expenditures with bank statements and supporting documentation, (6) reviewed grant agreements, amendments, Project Implementation Letters and related correspondence, and (7) interviewed A.I.D., Government of Madagascar, International Monetary Fund, World Bank and Price Waterhouse officials. Except where otherwise noted in the report, the U.S. dollar equivalents of the local currency Malagasy Franc (FMG) amounts were converted at the exchange rate that existed during our audit fieldwork in February 1991 (FMG 1,609 to U.S. $1.00). The equivalent dollar amounts are provided only to give the reader an indication of the dollar significance of the actual FMG activity and balances.

ACTION AID-3 INFO ECON POL/RLO

VZCZCTRO007NAO781 04-SEP-91 TOR: 13:43
RR RUEHNR CN: 06168
DE RUTHAN #4078 2471340 CHRG: AID
ZNR UUUUU ZZH DIST: AID
R 041340Z SEP 91 ADD:
FM AMEMBASSY ANTANANARIVO
TO RUEHNR/AMEMBASSY NAIROBI 1513
INFO RUEHC/SECSTATE WASHDC 4456
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UNCLAS ANTANANARIVO 04078

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AIDAC

NAIROBI FOR REDSO/ESA, ATTN T.JARMAN, RIG/A

E.O. 12356: N/A
SUBJECT: USAID/MADAGASCAR DRAFT AUDIT REPORT ON
- SECTOR ASSISTANCE PROGRAMS.(3-687-91-XX)

REF: A) DRAFT AUDIT, DATE AUG 7, 1991 WITH TJARMAN
- COVER LETTER; B) ANTANANARIVO 03361

1. DRAFT AUDIT REPORT RECEIVED ON AUGUST 13. DISCUSSION AND FINDINGS ARE CLEAR AND MISSION BELIEVES THE RECOMMENDATIONS TO BE REASONABLE. PLEASE ALSO SEE REF B, MISSION'S RESPONSE TO NFA DRAFT AUDIT.

2. THE FOLLOWING REPRESENTS A FEW SUGGESTIONS ON REWORDING OF FINDINGS FROM PAGE 7 WHICH SHOULD READ:

A. "A STUDY CARRIED OUT BY PRICE WATERHOUSE ON THE ROLE OF THE PRIVATE SECTOR AND THE GOVERNMENT IN MARKETING OF FERTILIZERS." (DELETE - "TOBACCO INDUSTRY.")

B. AET ... OK AS DRAFTED.

C. "A STUDY CONDUCTED BY ERNST AND YOUNG INTO THE OPTIONS AVAILABLE FOR INCREASING PRIVATE SECTOR PARTICIPATION IN THE TOBACCO AND EDIBLE OIL INDUSTRIES, AND TO IMPROVE THE PERFORMANCE OF THE MINISTRY OF AGRICULTURE'S PARASTATAL MONITORING UNIT."

3. REGARDING THE THREE DRAFT RECOMMENDATIONS AS FOUND ON PAGES 15, 20-21 AND 27:
THE USAID MISSION WILL TAKE IMMEDIATE STEPS TO IMPLEMENT AS RECOMMENDED, AND CLOSE, THE OUTSTANDING RECOMMENDATIONS.
A. NO.1.1. AS SOON AS MADAGASCAR'S BANKS RETURN TO NORMAL OPERATIONS (DUE TO PRESENT POLITICAL CRISIS AND ON-GOING STRIKES), USAID WILL ASCERTAIN THE EXACT STATUS OF IMPORTERS' DEPOSIT ARREARS, ESTIMATED TO BE FMG 120 MILLION (USDOLS 118,000).

B. NO.1.2. USAID WILL INSTITUTE MONITORING PROCEDURES TO ENSURE THAT CORRECT AMOUNTS FOR ALL PROJECTS WHICH GENERATE LOCAL CURRENCY ARE DEPOSITED INTO THE SPECIAL

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ACCOUNTS IN A TIMELY MANNER.

C. NO.2.1. USAID, AS SOON AS MADAGASCAR'S BANKS RESUME NORMAL OPERATIONS, WILL RE-ASCERTAIN THE TOTAL OF UNDISBURSED AND UNPROGRAMMED LOCAL CURRENCY (3RD AND 4TH TRANCHES) FROM BOTH MARS AND MAELP. ONCE THE GDRM IS CAPABLE OF EFFECTIVE OPERATIONS, USAID WILL REQUEST THAT ALL PRESENTLY UNPROGRAMMED L.C. FUNDS BE DISBURSED IN A TIMELY MANNER. USAID WILL ALSO MONITOR THESE DISBURSEMENTS.

D. NO.2.2. AS RECOMMENDED, USAID WILL ENSURE THAT THE DESIGN OF ALL FUTURE LOCAL CURRENCY-GENERATING PROJECTS ARE APPROPRIATELY PROGRAMMED AND SPENT IN A TIMELY MANNER. HOWEVER, BECAUSE OF STRINGENT REGULATIONS ON LC, USAID HAS DETERMINED THAT FUTURE NPA ACTIVITIES WILL NO LONGER GENERATE LOCAL CURRENCY. INSTEAD, WE PLAN TO TRANCHE FUNDING BASED ON PERFORMANCE-BENCH MARK ACHIEVEMENTS.

E. NO.3. USAID, AS SOON AS THE GDRM IS CAPABLE OF EFFECTIVE OPERATIONS, WILL MAKE A FORMAL REQUEST FOR THE GOVERNMENT TO PLACE ALL RESIDUAL MARS LOCAL CURRENCY FUNDS INTO AN INTEREST BEARING ACCOUNT AND TO TAKE RECESSING ACTION TO TRANSFER THESE FUNDS TO AN INTEREST BEARING ACCOUNT.

4. USAID WISHES TO ACT UPON AND CLOSE ALL RECOMMENDATIONS AS SOON AS POSSIBLE. HOWEVER, THE CURRENT POLITICAL/ECONOMIC UNREST HAS CONTINUED FOR MORE THAN THREE MONTHS. THERE ARE STILL NO NORMAL GOVERNMENTAL OPERATIONS. AS SOON AS NORMALCY RETURNS, USAID WILL INFORM RIG/A AND PROCEED TO IMPLEMENT RECOMMENDATIONS 1.1,1.2,2.1, AND 3. WE HAVE ALREADY BEGUN TO IMPLEMENT RECOMMENDATION 2.2. WALKER

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UNITED STATES GOVERNMENT

memorandum

DATE: September 19, 1991

REPLY TO ATTN OF: Fred C. Fischer, Director, REDSO/ESA

SUBJECT: Draft Audit of USAID/Madagascar Programs

TO: Toby L. Jarman, RIG/A/Nairobi

Thank you very much for the opportunity to review and react to the subject audit which I received on August 8, 1991. In general, we believe the audit and subsequent report were well done. We are particularly pleased to note that the audit team found the evaluation and oversight assistance REDSO officers provided relative to the conditions precedent correctly followed A.I.D. procedures.

The majority of the problems the audit team found were, as expected, in the difficult area of local currency management. We support the audit findings but remain concerned that in the current political environment the implementation of these recommendations maybe slow. What the report does reconfirm for us is that future designs should minimize as much as is possible the need to manage local currencies.

You maybe interested in a point we discovered ourselves after your team's visit. One of our economist examining a different problem discovered that GDRM has established a parallel overdraft account to the MAELP account. Thus, while the account we were shown had the expected balance, the Ministry of Finance had actually made a "loan" against it through an overdraft and used the funds for general revenue. Of course we assume that when it was programmed for a development project, the GRDM would have made good their "loan". One more reason for us to stay away from the need to program local currencies.

CONDITIONS PRECEDENT FOR MAELP CASH TRANSFERS AND THE EVIDENCE OBTAINED TO SUPPORT THEIR SATISFACTION

FIRST DISBURSEMENT

Conditions precedent to the first disbursement of $8 million are as follows:	Evidence obtained to support satisfaction of the conditions precedent is as follows:
(a) A statement representing and warranting that the named person or persons have the authority to act as the representative or representatives of the grantee pursuant to Section 6.2, together with a specimen signature of each person certified as to its authenticity.	The Government of Madagascar ("the Government") provided USAID/-Madagascar with the names and signatures of those people authorized to act as representatives of the Government.
(b) Evidence that the grantee, on the basis of prior discussions and agreement with A.I.D., has opened export marketing of the traditional export crops (coffee, cloves, pepper) to the private sector and is continuing to permit private exporters to operate on an equal basis with public sector firms.	Government decrees showing that the it had opened the export of traditional crops to private enterprise included decrees nos. 402 and 405 dated January 18 and June 2, 1988 respectively.
(c) Evidence that the grantee has instituted an Open General Licensing or an agreed alternative system to allocate foreign exchange in an open and market-clearing manner.	An official directive which required the processing of foreign exchange requests within six days and statistics from the Central Bank which reflected a significant increase in foreign exchange transactions.
(d) A letter which outlines the grantee's proposed schedule for meeting the conditions precedent	The Government submitted a letter to USAID/Madagascar on September 21, 1988 which outlined the Government's

set forth in Section 2.2.	schedule for meeting the conditions precedent for the second disbursement.

SECOND DISBURSEMENT

<u>**Conditions precedent to the second disbursement of $8 million are as follows:**</u>	<u>**Evidence obtained to support satisfaction of the condition precedents is as follows:**</u>
Evidence that the Government has successfully implemented policies and procedures to promote liberalized agricultural export market operations, and continued to allocate foreign exchange in an open and market clearing manner through the Open General Licensing System or an agreed alternative system, as determined by the following indicators:	
(a) The share of traditional crops (coffee, cloves, pepper) marketed by private operators has increased to at least 50 percent of total value for at least two of those crops.	Statistical evidence provided by the Government showed that in 1988 private operators were responsible for 53 percent of the value of pepper exports and 68 percent of the value of clove exports.
(b) There is free access to export markets for all non-traditional export crops.	Free access to export markets for all non-traditional export crops was indicated in statistical data which showed a significant increase in the export of non-traditional crops.
(c) The Open General Licensing System or agreed equivalent mechanism operates as planned with respect to permitting the importer to dispose of the full amount of foreign exchange applied for processing of the statistical import form within six working days of the submission of the statistical import form.	The Central Bank of Madagascar provided statistical evidence to USAID/Madagascar which proved that it was processing the statistical import forms within six working days.

(d)	The number of administrative approvals, clearances and fees for export transactions has been decreased and the time required to process an export shipment has been reduced to less than three days.	Government decree #88-015 dated September 5, 1988 reduced the number of administrative approvals, clearances and fees for export transactions. Based on the Mission's interviews with exporters, the condition precedent was satisfied.
(e)	The grantee has published an export guide providing a complete and concise summary of all export regulations in effect.	The Government published an initial export guide in the spring of 1988.

THIRD DISBURSEMENT

	Conditions precedent to the third disbursements of $6.29 million are as follows:	**Evidence obtained to support satisfaction of the conditions precedent is as follows:**
(a)	Documentation that the grantee has significantly reduced the remaining tariff disincentives to the competitive export of cloves and coffee, by undertaking actions such as: (1) consolidating all export levies into one ad valorem tax and (2) reducing the progressivity of the coffee tax schedule by the adoption of either a flat ad valorem tax or a less progressive tax schedule with fewer price bands than currently exist.	The Government significantly reduced the tariff disincentives to the competitive export of cloves and coffee. Documentation supporting reductions in tariff disincentives includes: (1) the 1989 finance bill #89-022 passed December 21, 1990 which consolidated the taxes on coffee and cloves into a single tax and (2) decree #89-471 which provided the details of this single tax.
(b)	Documentation confirming that the grantee will apply the same modalities of export taxes to all economic operators without	The Official Gazette #1976 (dated January 22, 1990) published a Government circular which stated that all exporters are to be paid at the time of shipment. As a

exception.

result of this decree the same payment modalities were applied to all exporters.

(c) Documentation that the grantee has sustained the promotion of agricultural export liberalization during calendar year 1989.

The Government provided the following documentation which proved that export liberalization efforts were continued during 1989: (1) a 1989 policy and action plan which outlined the Government movement toward trade liberalization, (2) statistical data on traditional and non-traditional exports through the third quarter of 1989, and (3) the establishment of a centralized office within the Ministry of Commerce to provide information and assistance for all export transactions.

(d) Documentation outlining the grantee's proposed schedule for meeting the additional conditions precedent to the fourth disbursement of this grant (Section 2.4 of the First Amendatory Agreement).

The Government provided USAID/Madagascar with an outline of its proposed schedule for meeting the conditions precedent for the fourth tranche.

FOURTH DISBURSEMENT

<u>**Conditions precedent to the fourth disbursement of $6.29 million are as follows:**</u>

<u>**Evidence obtained to support satisfaction of the conditions precedent is as follows:**</u>

(a) Documentation that the grantee has improved equal treatment of economic operators and transparency in export marketing and taxation of cloves and coffee in Madagascar, by undertaking actions such as: (1) ensuring that all economic operators, without exception, have access to Government contracts for

The following documentation was provided by the Government which proved that it had improved the equal treatment of all economic operators: (1) a copy of the invitation to bid and bid documents for an export sale of coffee on behalf of the Government, which were opened to all exporters on an open bid basis, (2) a certification by the Director of Customs which confirmed that all exports would be

	agricultural exports, (2) the application of equal treatment of all economic operators, without exception, with regard to the payment of export taxes, and (3) the adoption of regulatory texts relating to changes in the role and function of the Stabilization Board for Coffee, Vanilla and Cloves, which changes are to be consistent with the grantee's agricultural export liberalization program.	treated equally with regard to export taxes, and (3) government decrees 90-406, 90-407 and 90-408 which eliminated the coffee and clove stabilization boards. The government provided statistics that showed an increase in the percentage of exports handled by private enterprise versus parastatals.
(b)	Made additional progress in the liberalization and diversification of agricultural export marketing since the date of executing this First Amendatory Agreement.	
(c)	Establish and effectively implement a market information system that operates for the benefit of producers and exporters in Madagascar.	The Government established and maintained a market information system for use by producers and exporters. The first market information bulletin was published in November 1990, and subsequent bulletins were published in 1991.

APPENDIX IV

REPORT DISTRIBUTION

American Ambassador Madagascar	1
Mission Director, USAID/Madagascar	5
AA/AFR	1
AFR/EA/IOSEA	1
AFR/CONT	1
AA/XA	2
XA/PR	1
AA/LEG	1
GC	1
AA/FA	2
PFM/FM/FS	2
SAA/S&T	1
PPC/CDIE	3
MS/MO	1
REDSO/ESA	1
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AIG/A	1
D/AIG/A	1
IG/A/PPO	2
IG/LC	1
IG/RM	12
AIG/I	1
RIG/I/N	1
IG/A/PSA	1
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