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Regional Inspector General for Audit
Dakar

Audit of USAID/Morocco's Private Sector Export Promotion Project (No. 608-0189)

Audit Report No. 7-608-92-09
July 10, 1992

INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

AGENCY FOR INTERNATIONAL DEVELOPMENT
Office of the Regional Inspector General for West Africa

July 10, 1992

MEMORANDUM

FOR: Dennis M. Chandler, Director, USAID/Morocco

FROM: Paul E. Armstrong, RIG/A/Dakar

SUBJECT: Audit of USAID/Morocco's Private Sector Export Promotion Project (No. 608-0189), Report No. 7-608-92-09

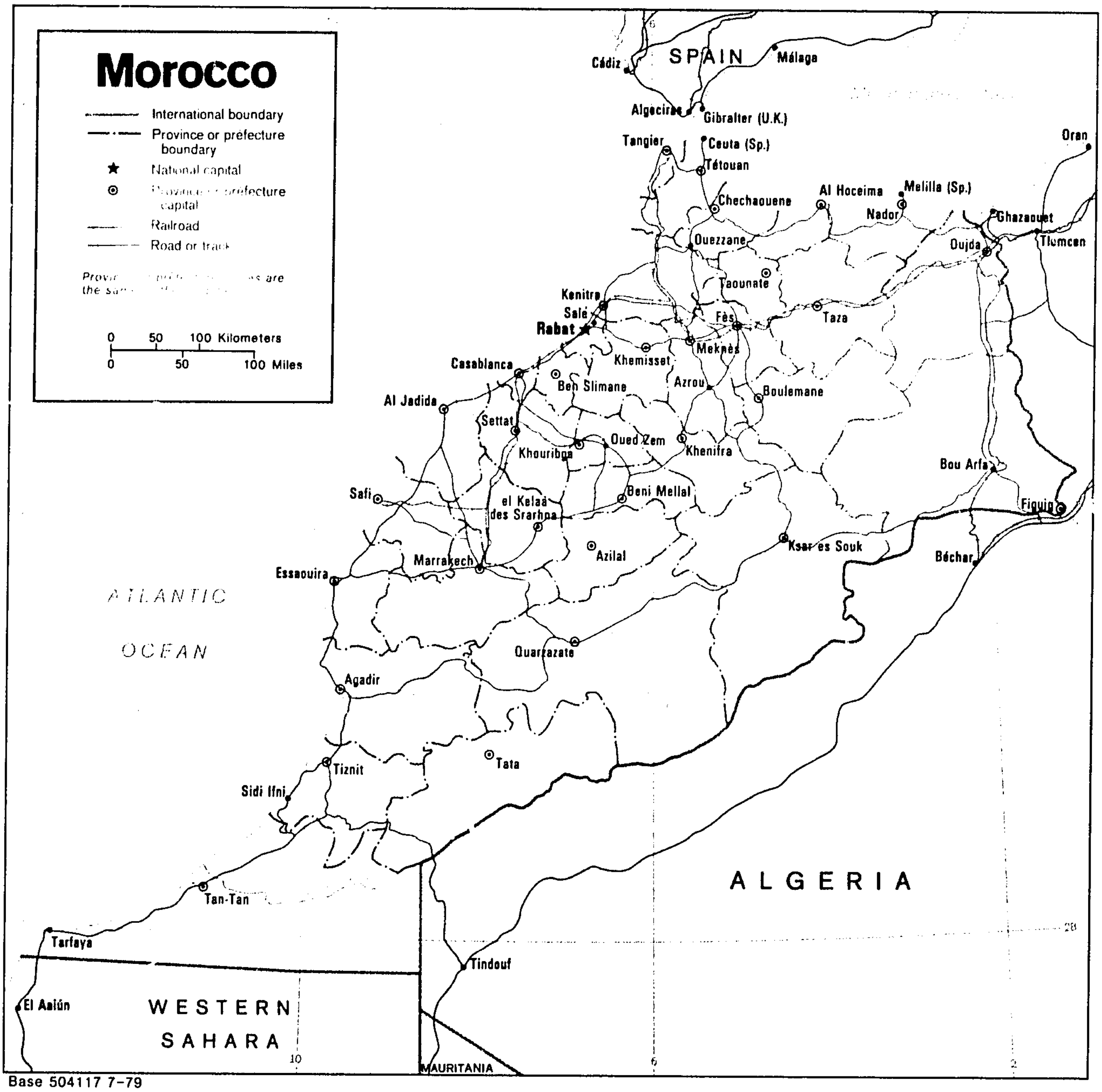
Enclosed are five copies of the subject audit report. We were not able to fully answer the audit objectives because USAID/Morocco management declined to provide us a representation letter confirming all of the information essential for us to render a professional conclusion. This scope limitation is discussed in more detail in Appendix II. A copy of the limited written assurances you did provide is included as Annex A of Appendix I.

We have included your comments on the draft report and our response thereto in Appendix I. Based on our evaluation of your comments and the supporting documentation you provided us, Recommendation Nos. 2 and 3 are closed upon issuance of this report and Recommendation No. 1 is unresolved. Please respond within 30 days, indicating actions planned or already taken to implement the unresolved recommendation.

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

Background

Confronted with diminishing foreign exchange reserves, large external debts and significant trade deficits, the Government of Morocco (GOM) initiated a series of economic reforms from 1983 to restructure and stabilize the Moroccan economy. To support this effort, A.I.D. initiated a seven-year project in 1986, designed to strengthen export capabilities of Morocco's private sector, thereby improving the country's balance of payments.



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Financed with A.I.D.'s Economic Support Funds, this $32.9 million Private Sector Export Promotion Project consisted of four principal components:

- An export credit insurance corporation, with significant private sector ownership, to insure Moroccan exporters against commercial risks. A.I.D. loaned $8 million to the GOM to establish a reserve fund for financing this activity.

- A credit program in collaboration with local commercial banks to provide working capital to eligible exporters. A.I.D. loaned the GOM $4.5 million to channel the funds to participating banks.

- A loan guarantee fund, administered by a commercial bank, to facilitate credit for small- and medium-sized exporters. A.I.D. granted $10.5 million for working capital and $0.9 million for other assistance.

- Technical assistance to the GOM and selected private enterprises to stimulate Moroccan exports, primarily through A.I.D.'s $4.1 million cooperative agreement with International Executive Service Corps, a U.S. private voluntary organization.

A.I.D. also obligated $1.4 million for other technical assistance, training, commodities and evaluations. Implementation responsibility is with the GOM's Ministry of Finance and participating commercial banks. GOM's contribution to support project operations was to total up to $3.5 million in local currency.

As of August 1991, A.I.D.'s obligations and expenditures totaled $29.4 million and $25.9 million, respectively. Project completion is scheduled for June 30, 1993.

Audit Objectives

The Office of the Regional Inspector General for Audit, Dakar, audited USAID/Morocco's Private Sector Export Promotion Project (No. 608-0189) as a part of the annual audit plan to answer the following objectives.

Did USAID/Morocco follow A.I.D. policies and procedures in:

1. ensuring that the Government of Morocco fulfilled conditions precedent and covenants of the project loan and grant agreements?

2. (a) controlling and accounting for project funds and (b) monitoring project expenditures?

3. monitoring, reporting and evaluating the project-funded cooperative agreement with the International Executive Service Corps?

In answering these objectives, we tested whether USAID/Morocco followed applicable internal control procedures and complied with certain provisions of laws, regulations and agreements. Our tests were sufficient to provide reasonable--but not absolute--assurance of detecting 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/Morocco followed A.I.D. procedures and complied with legal requirements. Therefore, we limited our conclusions concerning these findings to the items actually tested. But when we found problem areas, we performed additional work to:

- conclusively determine whether USAID/Morocco was following a procedure or complying with a legal requirement;

- identify the cause and effect of the problems; and

- make recommendations to correct the condition and cause of the problems.

Audit Findings

We are not able to fully answer our audit objectives because USAID/Morocco's management declined to provide us all the information essential for us to render a professional conclusion. For example, USAID/Morocco's management did not provide written confirmation that to the best of their knowledge and belief:

- they had provided us with all the essential information,

- the information they provided was accurate and complete, and

- they had followed A.I.D.'s policies and procedures.

A complete description of the information that the Mission would not confirm is provided in the Scope and Methodology section in Appendix II, and the limited written assurances provided by management are shown in Appendix I.

Without these written confirmations, we cannot fully determine whether the Mission did what it is required to do. We would, in essence, be stating that USAID/Morocco complied with A.I.D.'s policies and procedures when the Mission management itself was not willing or able to provide such a statement in writing.

While we therefore cannot state positively that USAID/Morocco followed applicable policies and procedures, this lack of management's written confirmation does not, however, preclude us from reporting on any problem areas that came to our attention. Based on the information provided to us and tests performed, we report the following problem areas.

Did USAID/Morocco follow A.I.D. policies and procedures in ensuring that the Government of Morocco fulfilled conditions precedent and covenants of the project loan and grant agreements ?

As discussed earlier, we cannot fully answer this audit objective. However, information provided by USAID/Morocco on its monitoring of the 13 conditions precedent and 14 covenants to the Private Sector Export Promotion project agreement, and documentary evidence of GOM's fulfillment of these conditions and covenants, disclosed one problem area: USAID/Morocco did not comply with A.I.D. procedures for extending the terminal date of an important condition precedent. Following is a discussion of this finding.

USAID/Morocco Did Not Follow A.I.D. Procedures For Extending The Terminal Date Of A Condition Precedent

Conditions precedent to the disbursement of A.I.D. funds are those provisions in a project agreement which are considered essential to project implementation. They are one-time actions which the host country must take within a specified period in order to proceed with project implementation. Mission Directors are authorized to extend terminal dates for meeting conditions precedent for no more than 180 days. Any extensions thereafter must be authorized by A.I.D./Washington, and A.I.D. Handbook 19 requires that A.I.D/Washington determine whether funds should be deobligated if conditions precedent are not satisfied within specified time frames.

USAID/Morocco did not comply with the above procedures. The project implementation agreement required GOM to fulfill six conditions precedent (CP) by March 1987 to enable A.I.D. to disburse $8 million of project funds for an export insurance reserve fund. One of these CP's required GOM to obtain an agreement with the participating export insurance corporation--an entity created under the project with significant GOM ownership--that A.I.D. funds would be only used to pay ordinary commercial losses to Moroccan exporters. This requirement was critical to project implementation because the insurance corporation faced multi-million dollar political default claims from Moroccan exporters due to their sizable losses on insured sales to Iraq and Libya. If the above agreement was not executed, there was a risk that the GOM could use A.I.D. funds to pay off those claims.

In April 1987, after GOM failed to provide the required agreement, the Mission Director extended the terminal date of this critical condition precedent for the permissible 180 days. When the GOM again refused to provide the required agreement during this extension period, the Mission obtained A.I.D./Washington's approval in October 1987 for another extension of 180 days. However, even the second extension expired in March 1988 without the GOM taking the required action. At this stage, the

Mission, rather than seek a third extension (which A.I.D./Washington may not have authorized) or deobligate the $8 million, continued to negotiate with the GOM for another year.

USAID/Morocco officials stated that they made a conscious decision not to comply with Agency internal control procedures by seeking a third extension because such action could be construed by GOM as a capitulation in the face of GOM's continued reluctance to ensure that A.I.D. funds would be used only to pay ordinary commercial risk claims.

Ultimately, in August 1989, the GOM executed an agreement with the export insurance corporation which stipulated that A.I.D.'s $8 million would not be used to pay political risk claims, and USAID/Morocco considered that this action fulfilled the condition precedent. A.I.D./Washington granted an extraordinary "retroactive" extension of the terminal date resulting in disbursement of the $8 million. However, in our opinion, USAID/Morocco's decision not to seek a third extension or deobligate the $8 million circumvented Agency internal controls requiring A.I.D./Washington's formal reassessment of projects when host governments do not fulfill key provisions of implementing agreements. We report this without a recommendation because the audit identified only this single instance of the deficiency.

Did USAID/Morocco follow A.I.D. policies and procedures in (a) controlling and accounting for project funds and (b) monitoring project expenditures ?

As discussed earlier, we cannot fully answer this audit objective. USAID/Morocco's documentation showed what actions were taken with regard to controlling and accounting for project funds and monitoring project expenditures as required by A.I.D. policies and procedures. However, based on the information provided and tests performed, we concluded that USAID/Morocco needs to strengthen its monitoring of project expenditures. The Mission did not (1) establish a system ensuring that required audits of project funds were undertaken and (2) maintain, update, and periodically reconcile memorandum ledgers for the $12.5 million loaned to GOM under the project. These findings are discussed below in detail.

USAID/Morocco Needs To Establish An Audit Management System

Federal financial management standards and A.I.D. procedures require sufficient audit coverage to safeguard project funds from unauthorized use. USAID/Morocco did not ensure adequate audit coverage of the Private Sector Export Promotion Project because it did not have a system in place to monitor the audits required under project authorizations and implementing agreements. Consequently, eleven planned audits of the project were not performed, exposing funds to the risk of loss and misuse.

Recommendation No. 1: We recommend that the Director, USAID/Morocco:

1.1 expeditiously arrange required audits of the $4.1 million cooperative agreement with the International Executive Service Corps, the $4.5 million pre-financing fund and the $8 million export insurance reserve fund under the Private Sector Export Promotion Project (No. 608-0189); and

1.2 establish a system to ensure that planned audits are completed in accordance with project financial plans and implementing agreements.

Office of Management and Budget Circular A-73 requires Federal agencies to provide adequate audit coverage of their programs. In accordance with this policy, Chapter 3 of A.I.D. Handbook 3 entitled Project Assistance requires that project designs include an evaluation of the need for audit coverage in light of the degree of vulnerability and overall accountability associated with each project. Ensuring completion of such audits is an important aspect of the Mission's financial monitoring mechanism.

The Private Sector Export Promotion Project design recognized the importance of audits to safeguard A.I.D.'s $29.4 million investment. Implementing agreements between A.I.D. and the GOM required ten recipient-funded audits and one non-Federal audit of A.I.D. funds between 1988 and 1991. However, none were performed. Exhibit I to this report provides a summary of the status of these eleven audits by project component.

The above audits were not done because USAID/Morocco's project monitoring system did not include adequate audit management procedures. In fact, the Mission Controller informed us that USAID/Morocco had no system for ensuring that audits were undertaken as required by project authorizations and implementing agreements.

By not ensuring completion of these eleven audits, A.I.D.'s investment of $16.6 million in three project components was vulnerable to loss or misuse without timely detection. For example, an audit of the project's $8 million export insurance reserve fund was an essential control mechanism on basis of which the funding was authorized. Without this audit, the Mission lacked independent and reliable information as to how the money was used or even the current balance of the fund. While accounting records provided to us by the export insurance company did not show any payments of Iraqi or Libyan defaults with the A.I.D. funds, only a financial audit would provide the needed assurance. Because of GOM's reluctance to agree to the condition precedent and the possibility of those funds being used to pay off such multi-million dollar insurance claims (as described on page 4), we believe that this financial monitoring deficiency could have had serious consequences.

Moreover, without the required audits of the project's prefinancing component, USAID/Morocco lacked independent assurance that participating Moroccan banks used

$4.5 million of A.I.D. funds for the intended purpose of providing credits to eligible exporters.

As for A.I.D.'s $4.1 million cooperative agreement with the International Executive Service Corps (IESC), Mission officials were concerned about IESC's accounting procedures and the propriety of certain expenses billed to A.I.D. Only an independent audit could be relied upon to provide needed information to management. The Mission arranged the required audit prior to the issuance of this report. It highlighted significant internal control weaknesses and identified unsupported and questioned costs totalling approximately $100,000.[1]

Had audits of the Private Sector Export Promotion Project been conducted as required in project authorizations and implementing agreements, USAID/Morocco would have had considerably greater assurance as to the financial integrity and the operational efficiency of this large project. In response to our draft audit report, USAID/Morocco described recent efforts to improve audit management at the Mission. Such efforts include a computerized project monitoring system which, once implemented, could effectively track required financial audits of project funds.

USAID/Morocco Needs To Establish Memorandum Loan Ledgers

The A.I.D. Controller's Guidebook requires Missions to establish memorandum loan ledgers to facilitate servicing and monitoring of foreign assistance loans. USAID/Morocco did not establish these records for the $12.5 million loaned to the GOM under the Private Sector Export Promotion Project because it relied on accounting reports generated by the A.I.D. Office of Financial Management in Washington. Consequently, internal controls over these funds were weakened and the loan accounts were exposed to potential errors or delinquencies without timely detection.

Recommendation No. 2: We recommend that the Controller, USAID/Morocco maintain, update and periodically reconcile memorandum loan ledgers for the Private Sector Export Promotion Project in accordance with A.I.D. procedures.

The Controller's Guidebook for Financial Management requires Mission Controllers to service foreign assistance loans, as well as collect and interpret current data on their financial status. Specific responsibilities include establishing and maintaining memorandum ledger accounts for each loan and periodically reconciling those ledgers to accounting records maintained by the A.I.D. Office of Financial Management, Washington (OFM).

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[1]USAID/Morocco had previously identified some of these unallowable costs through its voucher examination process.

USAID/Morocco did not maintain the required memorandum ledger accounts for the $12.5 million A.I.D. loaned to GOM under the Private Sector Export Promotion Project. Instead, the Mission relied on periodic financial reports provided by the OFM.

According to the Mission Controller, it was neither useful nor practical to maintain separate loan records at the Mission because OFM maintained the official accounts.

We do not concur with this rationale. Maintaining memorandum ledgers at the Mission level and periodically reconciling them to OFM records are control procedures required by A.I.D. and relied upon by OFM--controls which were not in place at USAID/Morocco for this $12.5 million loan. OFM management underscored the need for Missions to maintain these controls in its response to a recent OIG audit of A.I.D.'s Loan Accounting Information System (Audit Report No. 9-000-91-003 dated March 12, 1991), citing the importance of Missions maintaining and reconciling memorandum loan records in overseeing (1) A.I.D. disbursements and (2) loan repayments for countries with delinquencies. Morocco is one such country.

Did USAID/Morocco follow A.I.D. policies and procedures in monitoring, reporting and evaluating the project-funded cooperative agreement with the International Executive Service Corps?

As discussed earlier, we cannot fully answer this audit objective. However, based on the information provided to us and the tests we performed, we found that USAID/Morocco needs to strengthen its project evaluation procedures. This finding is discussed below.

USAID/Morocco Needs To Improve Its Project Evaluation Procedures

A.I.D. procedures specify various actions that should be taken by Missions upon completion of a project evaluation. USAID/Morocco did not take some of these required actions after completion of a mid-term evaluation of the Private Sector Export Promotion Project because Mission procedures did not provide comprehensive implementing guidance. Consequently, the usefulness and impact of the $82,500 evaluation was diminished.

Recommendation No. 3: We recommend that the Director, USAID/Morocco:

3.1 require the Mission's Evaluation Officer to ensure prompt completion of the evaluation summary report of the Private Sector Export Promotion Project's mid-term evaluation, including determining the required actions; establishing timeframes for completion; and designating officials to implement the actions; and

3.2 **revise Mission Order No. 023 to require that all Evaluation Review Committee decisions on findings and recommendations contained in evaluation reports be documented in the official project files.**

The primary purpose of a project evaluation is to inform management on key issues, such as the project's effectiveness and impact. Chapter 12 of A.I.D. Handbook 3 requires Mission Directors to ensure that evaluations are completed in accordance with prescribed procedures, including follow-up on evaluation recommendations and preparation of summary reports incorporating lessons learned and actions required. Missions are required to designate officials and establish time frames for implementing corrective actions.

In April 1990, USAID/Morocco completed a mid-term evaluation of the Private Sector Export Promotion Project and its cooperative agreement with the IESC at a cost of $82,500. The evaluation resulted in a number of findings and recommendations to improve project implementation. However, in October 1991, eighteen months later, USAID/Morocco had not completed the required evaluation summary, reporting its planned actions, time frames and officials designated to take needed actions.

This happened because Mission evaluation procedures did not adequately provide for such contingencies as staff turnover. For example, Mission Order No. 023 issued on June 13, 1986 requires a review committee to determine which evaluation recommendations are to be addressed, what actions are required and by whom they are to be implemented. However, it does not require that decisions made by the evaluation review committee be documented, information essential for preparing an evaluation summary report. While Mission officials stated that the committee considered the mid-term evaluation report, there are no records that evidence decisions made or actions planned in response to its findings and recommendations. Because of subsequent staff turnover and post evacuation due to the Gulf War, institutional memory was lost and the required evaluation summary was not completed.

Consequently, the overall impact and usefulness of this $82,500 evaluation was considerably diminished. While the Mission did implement some evaluation recommendations, other needed actions were not taken. For example, the Mission did not remedy two long-term cases of noncompliance with provisions of implementing agreements reported by the evaluators. These pertained to participating banks' control and use of $4.5 million of A.I.D. funds. In addition, no lessons learned analysis was shared with A.I.D. project designers.

Exhibit I

Private Sector Export Promotion Project
Status of Required Financial Audits of A.I.D. Funds
As of October, 1991

PROJECT COMPONENT	A.I.D. FUNDING	REQUIRED AUDITS	STATUS OF AUDITS
Pre-financing Fund (Note 1): Banque Centrale Populaire	$2.25 million*	1989, 1990, 1991	not done
Banque Marocaine du Commerce Exterieur	$2.25 million*	1988, 1989, 1990, 1991	not done
Insurance Reserve Fund (Note 2)	$8 million*	1989, 1990, 1991	not done
Cooperative Agreement (Note 3)	$4.1 million	1990	not done
Loan Guarantee Fund	$10.5 million*	1992	pending

Note 1: Financial plans in A.I.D.'s authorizing documents required periodic audits of the $4.5 million disbursed to two banks by A.I.D. under the pre-financing component. Implementing agreements between A.I.D. and the GOM required that these funds be audited annually. However, no audits were performed.

Note 2: Project agreements required annual audits of the A.I.D.-financed $8 million reserve fund as well as the export credit insurance corporation. However, while the financial statements of the export credit insurance corporation were certified by a local Commissariat aux Comptes, these statements did not disclose the balance or use of A.I.D.'s $8 million and no audits of the reserve fund were ever performed.

Note 3: A cost and compliance audit of the cooperative agreement between A.I.D. and the International Executive Service Corps was required to be performed in July 1990. However, this audit was not done.

* Audited disbursements

MANAGEMENT COMMENTS AND OUR EVALUATION

USAID/Morocco comments on our draft audit report and our evaluation are provided below.

USAID/Morocco Comments

SUMMARY

After reviewing the subject draft audit report, USAID Morocco has a number of corrections and recommendations to make. Overall the Mission strongly objects to the negative tone of the report resulting from the Mission decision to not sign a Letter of Representation. As RIG/A/Dakar is well aware, USAID management did not sign the representation letter pending Agency guidance on this issue, which is being addressed at the AID/Washington level by the RIG, AFSA, senior management and the General Counsel's Office. Furthermore, numerous verbal attestations by Mission management and staff were given to the auditors that all information was provided to them and that the Mission was not aware of any irregularities which have not been previously reported. The auditors have not cited any examples of concealment of information or irregularities. To negatively bias opinions due to the absence of a written representation letter does not promote the professional objectivity desired in any audit report and it raises doubts about the independence of audit personnel. Finally, in the absence of a prior decision by AID/W on the subject, the USAID/Morocco Director is including in this official Mission response the written representation letter, which should be included in the audit report as part of this Mission's formal reply.

RIG/A/Dakar Evaluation

Generally accepted government auditing standards require that the auditor obtain a representation letter from the auditee for performance audits, when deemed useful. The A.I.D. Inspector General has determined that representation letters should be obtained for all performance audits because they provide the additional documentary evidence necessary if the auditor to reach positive conclusions and attest to the positive performance of management. Our disclaimers of potentially positive findings in this report resulted from the Mission's refusal to provide an adequate representation letter (see Appendix II). However, such a conclusion does not constitute a negatively biased opinion; nor does it impair this report's professional objectivity, as the Mission has asserted.

USAID/Morocco Comments

The Mission believes that the draft audit report does not meet minimum government audit standards as prescribed by the GAO. Because there are so many factual inaccuracies, biased opinions, and unsubstantiated conclusions, we question whether such a poor quality draft would pass a peer review. Much of the discussion in the report is speculation based on purely hypothetical negative outcomes which have no factual basis and no place in an audit report. In fact, speculation about negative outcomes replaced a professional and objective presentation of findings based on the tremendous data reviewed and analyzed by the auditors.

RIG/A/Dakar Evaluation

Management's statements in this paragraph are either unsupported, incorrect or reflect its misunderstanding of generally accepted government auditing standards. The question of "biased opinions," for example, is addressed in our comments on the preceding page. As for "factual inaccuracies," management did identify one statistical error in the draft report (page 24), which was corrected in the final audit report. Furthermore, management's formal comments on one problem area discussed in the draft report gave us additional insight on the issue. As a result, the issue was excluded from the final audit report. This is an example of why the audit process includes issuance of a draft report of our findings to management for their review and comments. The "unsubstantiated conclusions" and "speculation based on purely hypothetical negative outcomes" are, in fact, discussions of risk exposure. For example, management's failure to ensure performance of required financial audits of project funds did indeed, in our opinion, expose those funds to an unacceptably high risk of misappropriation and other unauthorized use. In discussing this exposure in the audit report, we are reporting the effect of a weakness in the Mission's procedures, which is totally appropriate given the audit's objectives, and demonstrating the desirability of accepting our recommendations for corrective action--as required by generally accepted government auditing standards.

USAID/Morocco Comments

It should be emphasized that the audit report Section on Internal Controls concluded that for objectives one and three that "no significant internal control weaknesses came to our attention." Also, in the section on Compliance the draft audit report states that "based on the information provided by the Mission and tests performed, we can only report that no significant instances of non compliance with the aforementioned requirements came to our attention."

On the basis of information contained in our response, USAID/Rabat believes the following changes should be made on the final report:

Finding No. 1

The finding should be modified to indicate that, while the Mission technically did not follow Agency procedures for extending terminal dates for conditions precedent, it did so as part of a successful negotiating effort to protect USG interests.

Finding No. 2
Recommendation No. 1

The Mission requests that the Finding and Recommendation be deleted from the audit report in light of the information presented in the audit response concerning documentation of an Audit Management System considering the evidence given to the auditor and presented in the response.

Finding No. 3
Recommendation No. 2

The language in the draft audit report should be modified to restrict the recommendation to one loan, loan 608-k-046, per the audit scope. The audit recommendation should be closed as the memorandum loan record was submitted to the RIG as of the audit report date.

Finding No. 4
Recommendation No. 3

The Finding and Recommendation should be deleted as USAID/Morocco has no oversight responsibilities concerning PVOs' overall 25% contribution and the Mission is not mandated to account for the disposition of client fees, per OMB Circular A-110, dated July 30, 1976.

Finding No. 5
Recommendation No. 4

The Finding should be modified in the final report to correct the unsubstantiated conclusion that the usefulness of the $82,500 evaluation was "diminished". The Recommendation should be considered closed as the PES was completed and submitted to RIG as of the draft audit report date.

END SUMMARY

<u>*RIG/A/Dakar Evaluation*</u>

Our evaluation of Mission comments on the aforementioned findings and recommendations, including our detailed rebuttal of those comments with which we disagree, are provided on the following pages of this appendix.

USAID/Morocco Comments

SPECIFIC COMMENTS

FINDING NO. 1

Did USAID/Morocco follow A.I.D. policies and procedures in ensuring that the Government of Morocco fulfilled conditions precedent and covenants of the project loan and grant agreements?

USAID/Morocco Did Not Follow Agency Procedures for Extending Terminal Date of a Condition Precedent.

The discussion of this issue completely misses the point and contradicts the objectives of an IG audit. The Mission purposely did not comply with A.I.D.'s planned procedures in not seeking a third extension of the final CP in order to promote critical project objectives and protect USG resources. This was an explicit tactical decision on the part of the Mission Director during long and arduous negotiations with the GOM on A.I.D. financing of the SMAEX reserve fund. Mission management believed that it was essential that A.I.D. funds be used only to support the commercial risk reserve and not the political risk reserve. The GOM initially resisted this. As part of an ultimately successful negotiating strategy, the decision was made not to obtain a third extension of the CPs. This decision was explicitly discussed and documented during each quarterly project implementation review (PIR). AID/W was fully aware of this from PIR reporting as well as via other communications. It is also thoroughly documented in project files. When the GOM finally capitulated, the AA/ANE ratified and cabled approval of the Mission request for the extension of the terminal date. The negotiating tactic therefore worked, the Mission position was adopted, and USG funds were protected. After the CP was met and the disbursement made, AID/W commented in another cable to the Mission:

> "Thanks for the advice that the Credit Insurance component is finally moving again. It was obviously worth the wait after all. Congratulations for being tough-minded. We will note in weekly report to Administrator."

RIG/A/Dakar Evaluation

On February 28, 1989, eleven months after expiration of the condition precedent terminal date, USAID/Morocco cabled A.I.D./Washington requesting a retroactive extension of the terminal date. On March 22, A.I.D./Washington approved the extension and stated that:

> *"While we are pleased that the outstanding issues on this project are being worked out, we remind Mission that Agency procedures require prospective not retroactive approvals on extensions. Should a similar situation arise in the future, Mission should seek extension of the terminal date or proceed with deobligation. In truly exceptional situations, where communication of extension to the host country could give quote wrong signal unquote, unilateral extension could be utilized, but only after AA/ANE approval based on justifications presented" (State 089019).*

The Mission cabled back on April 3rd that " . . . it is pathetic to see that process is more important than substance to the author(s) of reftel." This exchange is quite different from the scenario reported above by management.

USAID/Morocco Comments

The importance of the issue and the correctness of the Mission position were further demonstrated during the Gulf crisis when the political risk reserve, which, as discussed above, A.I.D. had refused to fund, had to make heavy payment to cover substantial claims from Moroccan exporters who suffered losses in the Gulf.

The sentence *which AID/Washington may not have authorized* should be deleted. Can the auditors substantiate that AID/W would not have authorized the extension, particularly given the cables cited above? That is pure supposition, has no basis in fact, and is contradicted by the abovementioned record.

RIG/A/Dakar Evaluation

The report clearly states "may not have authorized," which management incorrectly implies is synonymous with "would not have authorized." Until A.I.D./Washington extended the terminal date of this condition precedent, it is pure supposition on the part of management that such authorization would be forthcoming. Therefore, we have not deleted the statement.

USAID/Morocco Comments

The references to Libya and Iraq in the text are unnecessary, irrelevant and inflammatory, causing one to question the motivation of the drafters of the report. As pointed out above, transactions with Libya and Iraq are covered by the non A.I.D. supported political risk reserve, not the AID supported commercial risk reserve; this was the point of the negotiation. The Mission was fully aware of the danger that the political risk reserve might have to pay substantial claims from those countries. One of the Mission's principal objectives in the negotiation and one of the reasons it was so adamant was precisely to avoid the possibility of large payments on defaults by those countries.

RIG/A/Dakar Evaluation

We do not concur with management's statement that "references to Libya and Iraq in the text are unnecessary, irrelevant and inflammatory." Including this information in the report highlights the importance of this condition precedent and, thereby, the importance of complying with A.I.D. procedures in administering any extension of its terminal date. Furthermore, exposure to Iraqi and Libyan defaults totalled approximately $23 million, a potential liability considerably higher than for other countries in the insurance company's political risk portfolio.

USAID/Morocco Comments

The sentence which alleges that this action *resulted in serious delays in project implementation* is wrong; the "serious delays" resulted from the Mission's taking a tough but necessary negotiating stance. Is the auditor suggesting that the Mission should have not taken such a stance and put USG resources at greater risk? To further claim that *$8 million of U.S. taxpayers money remained idle for two years* is simply not correct; the funds were committed, but not disbursed, until the CP was met and therefore did not remain idle anywhere. Once again, can the auditors document or substantiate an alternative with a more positive outcome?

RIG/A/Dakar Evaluation

The final report has been revised to incorporate these comments.

USAID/Morocco Comments

The last sentence in the section, which reads: *Furthermore, while the insurance corporation's internal accounts and supporting documentation provided to us did not show any payments of Iraqi or Libyan defaults with A.I.D. funds, only a comprehensive financial audit could provide reasonable assurance that these funds were not misused (see page 6)* should be deleted. The purpose of the Mission's hard negotiating position was, again, precisely to avoid this potential problem. The distinction between the uses of the commercial and political risk reserves is very clear to SMAEX and everyone else. In addition, as thoroughly discussed in the next section, the Mission had more than reasonable assurance that the funds were not utilized for Libya or Iraqi claims or otherwise misused. If the auditors have any evidence to the contrary, they should report it.

RIG/A/Dakar Evaluation

Management's premise in requesting that these statements be deleted seems to be that, once A.I.D. concludes an agreement governing the use of development funds, it can assume that the recipients will comply with terms of that agreement. We disagree with that premise. We have encountered many examples of noncompliance with agreements regarding everything from agreed-upon reforms to host-government contributions in the course of our audits in other countries, and have no reason to consider that compliance is guaranteed in this case, particularly when it was resisted by the GOM so strongly for so long. Moreover, audit clauses were incorporated in the implementing agreements as a means to obtain reasonable assurance that A.I.D.'s project funds were used for their intended purposes. We therefore stand by our statement.

USAID/Morocco Comments

The finding should be modified to impartially state that, while the Mission technically did not follow Agency procedures for extending terminal dates for conditions precedents, it did so with the full knowledge of AID/W as part of a successful effort to protect USG interests.

RIG/A/Dakar Evaluation

Based on our preceding evaluations of Mission comments on this finding, we do not concur with the above statement and have not incorporated it in the final report. As shown in our quotation of State 089019 (page 15), some A.I.D./Washington opinion exists to support Agency procedures requiring either extension of CP terminal dates or deobligation of funds as a valuable internal control to force reappraisal of stalemated projects.

USAID/Morocco Comments

FINDING No. 2

Recommendation No. 1

USAID/Morocco Needs to Establish an Audit Management System.

The implication of this recommendation is that USAID/Rabat has no procedures to schedule or track audits. This is totally incorrect as USAID/Rabat had in place procedures both at the audit date and draft audit report date to schedule and follow-up on required audits. The following actions/procedures demonstrate that the Mission does indeed have functioning audit management procedures.

1. Mission Order 1202 dated 10/25/91 and entitled "Procedures concerning IG Audit Staff Coordination and Responses to IG Audit Reports and Correspondence", clearly sets out and updates already existing procedures for the follow up for audit recommendations. In addition, it should be noted that the Mission has only one unclosed outstanding recommendation, which requires AID/W/GC resolution. (Recommendation No. 1 from audit No. 7-608-90-03 has been resolved, but not closed). A copy of Mission Order 1202 is attached (see Annex B).

RIG/A/Dakar Evaluation

Mission Order 1202 was issued after completion of our audit field work. This action indicates a desire by management to correct the material internal control deficiency discussed in this report. However, the Mission Order falls short of establishing needed controls. For example, it does not address how management is to ensure that all recipient-funded audits required under project agreements are completed and reported to the Mission--it merely establishes procedures for reviewing reports that are received. As a result, the Mission still has no system for ensuring that recipient-funded audits are undertaken. This weakness is significant because ten of the eleven required audits not performed under the Private Sector Export Promotion Project were to have been recipient funded.

USAID/Morocco Comments

2. The Mission annually schedules federal audits with RIG/A/Dakar commenting on the annual federal audit plan and scheduling additional audits when necessary.

RIG/A/Dakar Evaluation

Our records show that USAID/Morocco requested no such audits for fiscal years 1991 and 1992.

USAID/Morocco Comments

3. In September 1991, the Mission developed an audit universe of all auditable entities at USAID/Rabat to identify any overlooked audit requirements.

RIG/A/Dakar Evaluation

The Mission undertook this exercise at the request of the Office of the Inspector General during the course of the audit field work.

USAID/Morocco Comments

4. A schedule of non-federal audits needed for FY 93 was presented to RIG/A/Dakar on April 10, 1992 (Rabat 03627).

RIG/A/Dakar Evaluation

The Mission prepared this schedule well after completion of the audit field work. Furthermore, USAID/Morocco requested only one non-Federal audit between 1986 and commencement of our field work in 1991, despite having the largest A.I.D. program in RIG/A/Dakar's region.

USAID/Morocco Comments

5. The Project Implementation Monitoring System, a computerized tracking system, will track proposed audit dates by project. The proposed system was discussed with IG auditors in May and positively viewed. Furthermore, audit schedules are discussed on a formal basis as part of the semi-annual Project Implementation Reviews (PIRs).

RIG/A/Dakar Evaluation

Once implemented, the Project Implementation Monitoring System may be an effective tool for ensuring required audits of project funds.

USAID/Morocco Comments

While a highly formalized audit management system did not exist at the time of the audit (such as RIG would have preferred), audit management has been performed and the Mission has written procedures to schedule and follow up on required audits. The Mission agrees with the RIG that improvements can be made to the existing system and will continue its ongoing effort to formalize the existing system, including implementation of the Project Implementation Monitoring System, but it is factually incorrect to say that no system existed.

RIG/A/Dakar Evaluation

None of the eleven required audits of A.I.D. funds were performed for this project. The Mission Controller informed us on September 25, 1991 that neither his office nor the Mission as a whole had a system for tracking and following up on required audits. Furthermore, no information provided by management in response to our draft report demonstrated that a system existed at the time of our field work. We therefore disagree with management's assertions in the above paragraph. We do note, however, that subsequent to the field work, management took several positive steps towards implementing an effective audit management system and have included this information in the final report.

USAID/Morocco Comments

Private Sector Export Promotion Project
Status of Required Financial Audits of A.I.D. Funds
As of May, 1992 (date of Draft Audit Report)

PROJECT COMPONENT	A.I.D. FUNDING	REQUIRED AUDITS	STATUS OF AUDITS
Pre-financing (Note 1):			
Bank A/BCP	$ 2.25 million	1989, 1990, 1991	Audit of entire fund completed 11/91 by Price Waterhouse
Bank B/BMCE	$ 2.25 million	1988, 1989,1990, 1991	Entire fund audited 11/91 by Ernst & Young Affiliate
Insurance Reserve Fund	$ 8 million	1989, 1990, 1991	Completed for 1988, 1989, 1990 Commissariat aux Comptes.
Cooperative Agreement	$ 4.1 million	1990	Draft Report Completed 3/92 by Price Waterhouse
Loan Guarantee Fund	$10.5 million	1992	Scheduled 6/92, 12/92, 6/93 Rabat 03627

The draft audit report also implies that because some audits were not performed that the Mission had no information or control of the project. The discussion of the audits allegedly not carried out is inaccurate and unsubstantiated for all of the project components. (See Exhibit on preceding page summarizing the Status of Required Financial Audits).

RIG/A/Dakar Evaluation

The exhibit on the preceding page shows that three audits were undertaken subsequent to our field work. This represents progress towards establishing proper accountability over project funds, but does not render the audit report "inaccurate and unsubstantiated." Also, the audit report does not state or imply that management "had no information or control over the project." However, it does clearly state that required audits were not undertaken, exposing project funds to an unacceptably high risk of misappropriation and other unauthorized use. These issues are more fully discussed in our evaluation of Mission comments in the paragraphs below.

USAID/Morocco Comments

In the Export Credit Insurance Component, the Export Credit Insurance Company (SMAEX) is audited annually by the Government of Morocco's Commissariat aux Comptes. The Mission has been provided copies of these audits and has determined that they conform to government auditing standards and meet the audit requirement in the Project Agreement, as well as provide sufficient information for project monitoring.

RIG/A/Dakar Evaluation

The aforementioned reports of the Commissariat aux Comptes do not comply with generally accepted government auditing standards, and management is incorrect in concluding that they do. Most notably, they do not report on internal controls and compliance with applicable laws, regulations and agreements. A report on compliance would include specific tests and reporting of the Company's compliance with terms of the loan agreement for the $8 million of A.I.D. funds. Had the audit been performed in accordance with generally accepted government auditing standards, our concerns would be considerably diminished.

Furthermore, we do not concur with management's conclusion that the financial statements submitted to management provided sufficient information for project monitoring and fulfilled audit requirements of the Project Agreement. As discussed in the text of this report, nowhere did they even disclose the balance of the $8 million A.I.D. reserve fund.

In addition, USAID has had frequent personnel contact with SMAEX and the project manager visited the organization regularly. The Mission also had a long term resident advisor in SMAEX headquarters and provided a great deal of short-term technical advice.

RIG/A/Dakar Evaluation

The long-term resident advisor, according to the midterm evaluation, assisted the Company from 1987 to 1989. A.I.D. provided the $8 million reserve fund in August 1989. Therefore, this individual's role in monitoring the reserve fund would have been minimal.

USAID/Morocco Comments

The Mission has, therefore, been well aware of how the reserve fund has been utilized and of SMAEX's financial situation in general. SMAEX itself is a very visible corporation with both private and public shareholders and a Board of Directors. The commercial risk reserve fund was established by a loan from the Ministry of Finance and remains a legal obligation of the organization. The reserve fund, as well as other aspects of the project, has therefore been adequately monitored. The statements on Libya and Iraq should be deleted; as discussed above, the issue of commercial versus political risk was settled in A.I.D.'s favor, and there is no reasonable possibility that the A.I.D.-funded commercial risk reserve could be used to pay off political risk claims.

RIG/A/Dakar Evaluation

We do not concur with management's conclusion. As discussed in the report, management did not have any independently verified information on the use or balance of the A.I.D.-funded $8 million reserve fund (and, in fact, had no information at all regarding the balance of the fund).

USAID/Morocco Comments

It is correct to state that the two participating banks in the Export Pre-Financing component did not perform the required audits. While the Mission does not believe that annual audits of this credit line are in fact necessary, USAID has reminded the banks of their responsibility to undertake the audits and the entire portfolio of loans under this component has now been audited (see table). The Mission has copies of these audits on file and no problems were found.

RIG/A/Dakar Evaluation

We are pleased that management has, after we pointed out the non-compliance with audit requirements contained in project authorizations and implementing agreements, now initiated these audits.

USAID/Morocco Comments

However, the allegation that *USAID/Morocco had no reliable assurance that $4.5 million disbursed by Moroccan banks under the project's pre-financing component was used for the intended purpose of providing credit to eligible borrowers* (page 7) is entirely incorrect and unsubstantiated. The participating banks are the two largest banks in Morocco and have successfully implemented many different credit lines from a variety of internal and external sources. They provided the required quarterly reports to USAID in a timely manner giving full information on all loans outstanding. These reports were regularly reviewed by USAID project officers, who were also in contact with the responsible staff at the two banks, and were provided to the RIG auditors.

RIG/A/Dakar Evaluation

We agree that management selected two large banks to administer the credit line and ensured that the banks provided the required quarterly reports. Nevertheless, this does not eliminate the need for periodic independent audits of the program, as required both in A.I.D.'s project authorization and the Project Agreement. We do not believe that unaudited periodic financial reports submitted by bank officials to USAID/Morocco provide a reliable and objective assessment of the $4.5 million activity. Furthermore, project evaluators concluded that these reports, which were prepared by the banks administering the credit line, "contain little information."

USAID/Morocco Comments

The project, including this component, was also externally evaluated in the Spring of 1990, and no problems were identified. Therefore, even without the audits, USAID project officers were in a good position to verify that the loans were being used for the intended purposes. Did the auditors uncover any evidence to the contrary? It should also be pointed out that the banks have not *disbursed* the $4.5 million; the disbursement was from USAID to the GOM, and the funds were on-lent to the banks.

RIG/A/Dakar Evaluation

The evaluators reported on the four eligibility criteria governing the participating banks' use of the A.I.D. funds. Their report concluded that the banks' compliance with the first criterion could only be determined through an audit of the program. It was silent on the banks' compliance with the second criterion and stated that the third and fourth criteria have presumably been respected, "although this is practically unverifiable." While management is technically correct in stating that "no problems were identified" resulting from the lack of audits, the evaluation certainly did not provide information that in any way substituted for an audit of the $4.5 million A.I.D.-funded credit line.

USAID/Morocco Comments

As for the allegations concerning the IESC audit, the projected July 1990 audit was simply a planned date, one year after the Cooperative Agreement Amendment of the summer of 1989. Initiation of the audit was purposely delayed because of the departure of the project manager from Rabat and the subsequent evacuation of the new project manager during the Gulf crisis. The major concern on the timing of the audit was that it be conducted prior to a new IESC agreement; since the current agreement was extended (no-cost) for one year, it was not necessary to undertake the audit by July 1990. The Mission has been fully aware of this audit requirement and plans for it were well underway prior to the RIG audit; in fact, discussions were held with RIG/Dakar on the subject, and a draft statement of work obtained. Delay of the audit was an explicit, reasonable decision and had nothing to do with the alleged lack of an audit control system. The audit has now been drafted, and the results are being utilized in the design of the new IESC project (Non-Federal Audit draft supplied to auditors 5/8/92).

RIG/A/Dakar Evaluation

Management's chronology of events here is misleading to the reader. In fact, the Mission held no discussions with RIG/A/Dakar on the IESC audit until after our Private Sector Export Promotion audit field work was underway. Moreover, each year the Office of the Inspector General requests Mission management's input for the annual non-Federal audit plan. USAID/Morocco's input should have included a request for the IESC audit. For fiscal years 1991 and 1992, USAID/Morocco informed us that it planned no non-Federal audits. Then, during our field work in July 1991, management requested assistance in arranging a non-Federal audit of the IESC cooperative agreement.

USAID/Morocco Comments

The extensive audits required in the Loan Guarantee Fund are not delinquent nor do the auditors make any claim that they are delinquent in the draft report. Why then does the RIG claim that "by not scheduling these eleven audits, A.I.D.'s investment of $29.4 million was vulnerable to loss or misuse without timely detection"? Futhermore, the project total without the Guarantee Fund is only $18.0 million.

RIG/A/Dakar Evaluation

Management is correct that the eleven audits which were not performed applied to $16.6 million of project funds. Audits of the recently established $10.5 million loan guarantee fund were not yet due. This has been corrected in the final report.

USAID/Morocco Comments

The Mission requests above Finding and Recommendation be deleted from the final audit report on the basis of the information presented in this response.

RIG/A/Dakar Evaluation

We have not acquiesced in management's request for reasons explained above and have retained this recommendation in the final report.

USAID/Morocco Comments

FINDING No. 3

Recommendation No. 2

USAID/Morocco Needs To Establish Memorandum Loan Ledgers

The suggestion that USAID/Morrocco has no memorandum loan ledger is grossly false. USAID/Morocco has a loan ledger and has had one for the past 30 years. The Mission did not have a formal record for loan 608-K-046, but does have an active working file and has memorandum loan records for 60 other active USAID loans.

RIG/A/Dakar Evaluation

The draft report clearly stated that "USAID/Morocco did not maintain the required memorandum ledger accounts for the $12.5 million A.I.D. loaned to GOM under the Private Sector Promotion Project," (Loan No. 608-K-046). However, because of management's concern over potential misunderstandings, we have provided additional clarification in the final report (pages 7 and 8).

USAID/Morocco Comments

The audit report was also inaccurate in stating *USAID/OFM management underscored the need for these controls in its response to a recent RIG audit of A.I.D.'s Loan Accounting Information System (Audit Report No. 9-000-91-003 dated March 12, 1991), citing the importance of Missions maintaining and reconciling loan records in (1) overseeing A.I.D. disbursements and (2) for countries such as Morocco which do not repay principal and interest in a timely manner, taking prompt action to minimize delinquencies* (Page 8)."

In fact, Mission loan records are simply working files and not the controlling documents for countries such as Morocco which do not always repay principal and interest in a timely manner. There are two reasons for this situation, as follows:

1. Morocco has had five Paris Club rescheduling. Since these rescheduling involve complex changes in payments which are due, and create new loans with unique amortization schedules, the Mission must utilize Washington records. The Mission does not have the information to make such calculations. Furthermore, AID/W calculations and records become the basis for new bilateral agreements signed between the USG and the GOM, which are binding and controlling.

2. As payments made by the GOM are often made for a number of loans (i.e. combination payments), these payments are frequently applied to loans other than those specified by the GOM. AID/Washington decides which payments are to be credited against Morocco's loan payments due and therefore may apply the payments in a manner different than stipulated by the GOM and previous Mission records. The Mission must utilize AID/W loan records for collection/billing purposes rather than memorandum loan accounts maintained on the basis of GOM submissions.

RIG/A/Dakar Evaluation

We agree with management that memorandum loan ledgers do not constitute official accounting records. Rather, they are a part of A.I.D.'s internal control system to reconcile USAID records with official ones, a control called for in the Controller's Guidebook for Financial Management. These controls were not in place for the $12.5 million A.I.D. loaned to the GOM under the Private Sector Export Promotion Project. The audit finding and related recommendation are intended to correct this deficiency.

USAID/Morocco Comments

In conclusion, the Mission believes that, although the loan record for Loan 608-K-046 was not formally created in the loan ledger, adequate control of disbursements for this loan was maintained by the working file due to the fact that only five disbursements were made under this loan and that control of repayments of other loans was maintained by AID/W's official loan ledger and Notices of Payment Due.

Accordingly, the language in the draft audit report should be substantially modified to restrict any recommendation to one loan, loan 608-K-046, per the audit scope. The audit recommendation should be closed as a memorandum loan record was submitted to RIG as of the draft audit report date (see Annex C).

RIG/A/Dakar Evaluation

The memorandum ledger recently established for the $12.5 million A.I.D. loaned to the GOM under the project (Loan No. 608-K-046) satisfies Recommendation No. 2, which is therefore closed upon issuance of this report.

USAID/Morocco Comments

FINDING No. 4

Recommendation No. 3

RIG/A/Dakar Evaluation

Based on additional information provided to us by management in response to the draft audit report, we have eliminated this finding in the final report.

USAID/Morocco Comments

FINDING No. 5

Recommendation No. 4

We recommend that the Director, USAID/Morocco:

4.1 require the Mission's Evaluation Officer to ensure prompt completion of the evaluation summary report of the Private Sector Export Promotion Project's mid-term evaluation, including determining the required action; establishing time frames for completion; and designating officials to implement the actions; and

4.2 revise Mission Order No. 023 to require that the evaluation review committee decisions be documented in the official project files.

The A.I.D. Evaluation Summary (AES) for the project evaluation was prepared by the Project Officer prior to his departure from post, cleared by the Project Division Chief and the Evaluation Officer and returned by the Deputy Mission Director for some final editing. For a number of reasons, including the massive desumptions caused by the Gulf War and consequent evacuation of staff, it was not signed by the Mission Director and submitted to AID/W at that time. However, it was subsequently signed by the Mission Director on January 24, 1992, and transmitted to AID/W on January 25, 1992. A copy has been forwarded to RIG/Dakar with comments on the draft audit report. (See Annex D)

While the AES was not signed by the Mission Director and submitted to AID/W on time, the IG allegation that the Mission had not *determined its planned actions, established time frames or designated officials to implement the recommendations* is neither accurate nor substantiated. The Project Committee met, discussed the evaluation, and determined actions to be taken on its recommendations. The results of this meeting formed the basis for the AES. As is often the case, the evaluation contained a large number of recommendations, not all of which were actionable or useful. However, they were all considered. The ones which we judged important were included in the AES, assignments were made and, by the time of the audit, actions had been taken. The decisions and follow-up actions on each of the recommendations were thoroughly discussed with the auditors in October 1991. The Mission can furnish a written list of these again if desired. If there were any evaluation recommendations which were not adequately considered and appropriately followed up, the auditors should document them.

Mission Order No. 023 has been reissued as MO No. 303 which explicitly requires that decisions on evaluation recommendations be formally approved and documented. A copy is included in Annex E.

The audit conclusion that *Consequently the impact and usefulness of the $82,500 evaluation was considerably diminished* (Page 10) is very inaccurate. The Mission fully utilized the evaluation and considered and approximately implemented its recommendations, including not obligating the remaining funds in the Export Pre-Financing Component ($3.5 million) and establishing a Loan Guarantee Fund. Can the auditors document in any way how the usefulness of the evaluation was diminished? If not, the sentence should be deleted from the report.

RIG/A/Dakar Evaluation

Particularly troubling to us is the fact that the evaluation report identified two long-term cases of contractual default by participating Moroccan banks regarding control and use of A.I.D. funds, which the Mission did not remedy. In our opinion, this inaction considerably diminished the impact and usefulness of the evaluation.

USAID/Morocco Comments

The finding should be modified in final report to correct the erroneous conclusion that the usefulness of $82,500 evaluation was "diminished". The recommendation should be considered closed as the AES was completed and submitted to RIG as of the audit report date.

RIG/A/Dakar Evaluation

Based on management's completion of the Evaluation Summary and issuance of Mission Order No. 303, Recommendation No. 3 in the final report is closed.

USAID/Morocco Comments

Issues Needing Further Study

RIG/A/Dakar Evaluation

This section pertained to matters not included in the final audit report.

USAID/Morocco Comments

CONCLUSION

RE-DRAFTED PARAGRAPH NOW READS:
IN SUMMARY, THE MISSION BELIEVES THE AUDIT DRAFT REPORT WAS INADEQUATE. WE ATTRIBUTE MANY OF THE SHORTCOMINGS AND DIFFICULTIES OF THE REPORT TO THE AGENCY WIDE DISPUTE OVER THE "REPRESENTATION LETTER." WE BELIEVE THIS ISSUE INTRODUCED A FACTOR UNNECESSARY AND EXTERNAL TO DOING AN OPERATIONAL PERFORMANCE AUDIT. PLACING SO MUCH EMPHASIS UPON THE "REPRESENTATION LETTER" SERVED TO REDUCE THE USEFULNESS OF THE DRAFT AUDIT REPORT. THE BOTTOM LINE IS THAT THE IG INSTRUCTIONS ABOUT THE "REPRESENTATION LETTER" OBVIOUSLY RESTRAINED THE RIG STAFF FROM DOING A MORE BALANCED REVIEW; THUS THE AUDIT WAS INCOMPLETE. SUPPORTING OUR CONCLUSIONS IS THE AMOUNT OF ADDITIONAL DATA WE HAVE FURNISHED IN THIS RESPONSE WHICH FILL IN GAPS THAT A MORE BALANCED REVIEW MIGHT HAVE AVOIDED.

Note: *USAID/Morocco requested that the above paragraph be included in place of its original conclusion.*

REPRESENTATION LETTER
USAID/MOROCCO

May 18, 1992

Paul E. Armstrong
RIG/A/Dakar
c/o American Embassy
Dakar, Senegal

Dear Mr. Armstrong:

This is in regard to the draft audit which you have recently completed "Audit USAID/Morocco's Private Sector Export Promotion Project (No. 608-0189)." I have asked appropriate members of my staff to make available to you all records in our possession for the purpose of this audit. Based on the representations made by those individuals to me, I believe that those records are accurate and complete, and that they give a fair representation as to the status of The Private Sector Export Promotion Project. After review of your draft audit report and consultation with my staff, I know of no other facts (other than those expressed in the Mission comments given in response to the draft report) which, to the best of my knowledge and belief, would materially alter the conclusions reached in the draft report.

I request that this Representation Letter be considered a part of the official Mission comments on the draft report, and be published along therewith as an annex to the report.

Sincerely,

Dennis M. Chandler
Director

RIG/A/Dakar Evaluation

See Appendix II for our evaluation of management's representation letter.

SCOPE AND METHODOLOGY

Scope

We performed the audit of USAID/Morocco's Private Sector Export Promotion Project (No. 608-0189) in accordance with generally accepted government auditing standards, except that USAID/Morocco's management would not provide us with a representation letter confirming information essential to fully answer the audit objectives. Management's refusal to make such representations constitutes a limitation to the scope of the audit. The Director of USAID/Morocco did provide us with limited written assurances (see page 30), but Mission managers would not confirm in writing, to the best of their knowledge and belief, the information we deemed essential to answer our audit objectives. Following is an analysis of (1) the information that we requested the Mission Director, Controller and cognizant Project Officers to confirm to us, to the best of their knowledge and belief, in a representation letter and (2) the limited written assurances, signed only by the Mission Director, provided in response.

- We requested the aforementioned Mission officials to confirm whether they are responsible for the internal control system, compliance with applicable laws and regulations, and the fairness and accuracy of accounting and management information for the organization under audit. However, the letter provided to us does not acknowledge these responsibilities.

- We requested the Mission officials to confirm whether they have provided us with all the financial and management information associated with the activity under audit, but the letter provided to us does not confirm this information. Instead, it only attests to the fact that the Director asked his staff to make all records available to us.

- We requested the Mission officials to confirm whether they know of any irregularities in the activity under audit. However, the letter provided to us does not address this question.

- We requested the Mission officials to confirm whether they know of any material instances where financial or management information have not been properly and accurately recorded and reported. Instead, the letter provided to us only affirms that the Director understands from his staff that the records are complete and accurate.

- We requested the Mission officials to confirm whether they are aware of any instances of noncompliance with A.I.D. policies and procedures or violations of laws and regulations. However, the letter provided to us does not address this question.

- We requested the Mission officials to confirm whether they have complied with contractual agreements. However, the letter provided to us does not address this question.

- We requested the Mission officials to confirm whether they know of any events subsequent to the period under audit that could affect the above representations. However, the letter provided to us does not address this question either.

The answers to the above questions are so fundamental to the basic concepts of auditing that it is not possible to render a positive opinion without them. Thus, if managers will not confirm their answers to these questions in writing through a representation letter, then we cannot risk giving a positive opinion.

While we cannot make a positive conclusion without such representations, this lack of management confirmation does not preclude us from reporting on any problem areas that came to our attention and we have done so.

We conducted the audit from July 30 to October 10, 1991 at the A.I.D. Mission in Rabat as well as the offices of the International Executive Service Corps and participating financial institutions in Rabat and Casablanca, Morocco. The audit covered USAID/Morocco's systems and procedures related to the $25.9 million A.I.D. disbursed under the Private Sector Export Promotion project for: controlling, monitoring and accounting for project funds ($24.9 million tested); ensuring compliance with conditions precedent and covenants contained in project agreements ($23.0 million tested); monitoring, reporting and evaluating the project cooperative agreement ($1.9 million tested).

In answering the audit objectives, we obtained documentary and testimonial evidence from officials of USAID/Morocco, International Executive Service Corps and participating financial institutions; assessed internal controls, reliability of computer-generated data and compliance with laws and regulations applicable to each objective; considered related prior audits; and verified evidence through examination of supporting documentation.

Methodology

Audit Objective One

For the first objective, we considered criteria in the Federal Managers' Financial Integrity Act, A.I.D. Handbooks 3 and 19. We then assessed Mission procedures for monitoring conditions precedent and covenants, and for ensuring Government of Morocco's fulfillment of conditions precedent prior to disbursement of A.I.D. funds. Our tests included examination of evidence of GOM's fulfillment of conditions precedent and status of its compliance with covenants contained in project agreements, and covered the $23 million which USAID/Morocco disbursed under the project which were subject to such requirements.

Audit Objective Two

To accomplish the second objective, we considered related criteria in the Federal Managers' Financial Integrity Act, OMB Circular A-73, Controller's Guidebook for Financial Management, A.I.D. Handbooks 3 and 19; and then interviewed project officials, reviewed project accounts, supporting documentation and control procedures to determine the Mission's compliance with the applicable criteria. Substantive testing included examination of obligating, earmarking and commitment records and accounts for $27 million of the $29.4 million authorized; approvals, supporting documents and accounts for $24.9 million of the $25.9 million disbursed. In addition, we assessed Mission compliance with project financial plans, A.I.D. advance/liquidation regulations and loan servicing procedures; and reviewed internal accounts and supporting documentation relating to AID disbursements at participating Moroccan financial institutions.

Audit Objective Three

To accomplish the third objective, we considered criteria in the Federal Managers' Financial Integrity Act, A.I.D. Handbooks 3 and 13. We then assessed Mission procedures for monitoring, evaluating and reporting on the project's cooperative agreement with International Executive Service Corps. Our tests included examination of progress and evaluation reports, interviews with Mission and IESC officials, and covered the $1.9 million disbursed to International Executive Service Corps under their project-funded cooperative agreement with A.I.D.

REPORT ON INTERNAL CONTROLS

This section provides a summary of our assessment of USAID/Morocco's internal controls related to each audit objective.

Scope of Our Internal Control Assessment

We conducted our audit in accordance with generally accepted government auditing standards, except that management would not provide us with a representation letter confirming, among other things, its responsibility for the internal controls related to the audit objectives or confirming whether or not there were any instances of noncompliance with A.I.D. policies and procedures or whether or not it had provided us with all the information related to this program.

Management's refusal to make such representations constitutes a limitation to the scope of the audit sufficient to preclude an unqualified opinion on the reliability on the internal controls related to the audit objectives. (A complete description of the written representations that USAID/Morocco would not make is provided in the Scope and Methodology section of this report.)

We limited our assessment to those internal controls applicable to the three audit objectives and therefore did not assess USAID/Morocco's overall internal control structure.

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

General Background on Internal Control

Under the Federal Managers' Financial Integrity Act and the Office of Management and Budget implementing policies, A.I.D. management is responsible for establishing and maintaining adequate internal controls. The General Accounting Office has issued "Standards for Internal Control for the Federal Government" to be used by agencies in establishing and maintaining internal controls. The objectives of internal controls for

Federal foreign assistance 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 and irregularities may occur and not be detected. 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

We reviewed USAID/Morocco's internal controls for the conditions precedent and covenants process. We were not, however, able to conclude on the reliability of these controls, as management was not willing or able to confirm in a representation letter essential information related to these controls.

Because of this lack of management information, we cannot therefore state positively that the internal controls related to this audit objective are effective and can be relied on. However, based on the information provided by the Mission and tests performed, we can only report that no significant internal control weaknesses came to our attention, other than USAID/Morocco's inability to confirm essential information about its own internal controls.

Conclusions for Audit Objective Two

We reviewed USAID/Morocco's internal controls relating to the accounting and monitoring of project funds and, for the purpose of this report, have categorized them as follows: the fund control process; the payment process; and the verification of expenditures process.

We were not able to conclude on the reliability of controls related to the fund control and payment processes because management was not willing or able to confirm in a representation letter essential information related to these controls. Because of this lack of management information, we cannot therefore state positively that internal controls related to the fund control and payment processes are effective and can be relied on. However, based on the information that USAID/Morocco provided and tests performed, we can only report that no significant internal control weaknesses related to these two processes came to our attention, other than USAID/Morocco's inability to confirm essential information about its own internal controls.

However, our assessment of internal controls related to the verification of expenditures process showed that these controls were not properly designed and/or implemented. USAID/Morocco did not:

- establish and document Mission procedures for initiating, tracking and following up on required audits of project funds; and

- maintain and reconcile required memorandum records of foreign assistance loans made under the project.

Conclusions for Audit Objective Three

We reviewed USAID/Morocco's internal controls for the monitoring, evaluation and reporting processes of the project's cooperative agreement with International Executive Service Corps. We were not, however, able to conclude on the reliability of these controls, as management was not willing or able to confirm in a representation letter essential information related to these controls.

Because of this lack of management information, we cannot therefore state positively that the internal controls related to this audit objective are effective and can be relied on. However, based on the information provided by the Mission and tests performed, we can only report that no significant internal control weaknesses came to our attention, other than USAID/Morocco's inability to confirm essential information about its own internal controls.

REPORT ON COMPLIANCE

This section summarizes our conclusions on USAID/Morocco's compliance with applicable laws, regulations and agreements.

Scope of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards, except that management would not provide us with a representation letter confirming to the best of their knowledge and belief (1) their responsibility for compliance with applicable laws and regulations, (2) whether or not there were any irregularities involving management or employees, (3) whether or not there were any instances of violations or possible violations of laws and regulations. (A complete description of the representations that USAID/Morocco management would not make is provided in the Scope and Methodology section of this report.)

Management's refusal to make such representations constitutes a limitation to the scope of the audit and is sufficient to preclude us from designing our audit to provide reasonable assurance of detecting abuse and illegal acts and from giving an unqualified opinion on USAID/Morocco's compliance with provisions of project grant, loan and cooperative agreements applicable to the audit objectives.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grant and binding policies and procedures governing an organization's conduct. Noncompliance constitutes an illegal act when there is failure to follow requirements of laws or implementing regulations, including intentional or unintentional noncompliance and criminal acts. Not following internal control policies and procedures in A.I.D. Handbooks generally does not fit into this definition of noncompliance 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 or regulations but violate either their spirit or the more general standards of impartial and ethical behavior. Compliance with project grant, loan and cooperative agreements is the responsibility of USAID/Morocco management.

Conclusions on Compliance

We reviewed USAID/Morocco's compliance with provisions of project grant, loan and cooperative agreements related to project funding. Because management was not willing or able to confirm in a representation letter essential information related to such compliance, we cannot state positively that USAID/Morocco has complied with the above agreements. However, based on the information provided by the Mission and tests performed, we can only report that no significant instances of non-compliance with the aforementioned requirements came to our attention.

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