Regional Inspector General for Audit
Nairobi, Kenya

Audit of USAID/Rwanda's Management of Host Country-Owned Local Currency

Report No. 3-696-93-08
March 19, 1993

INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID
U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

March 19, 1993

Regional Inspector General for Audit/Nairobi

MEMORANDUM

TO : Director, USAID/Rwanda, Gary L. Nelson

FROM : RIG/A/Nairobi, Everette B. Orr Everette B. Orr

SUBJECT: Audit of USAID/Rwanda's Management of Host Country-Owned Local Currency-Task No. 33101392

Enclosed are five copies of our audit report on USAID/Rwanda's Management of Host Country-Owned Local Currency, Report No. 3-696-93-08.

We reviewed your comments on the draft report and included them as an appendix to this report. Recommendation Nos. 1.1, 1.2, 3.1, 3.2, 4.1, 4.2, and 5 resolved but not closed. These recommendations will be closed when appropriate actions are completed. Recommendation Nos. 2 and 6 are unresolved pending concurrence with the recommendations as stated in the report. Please respond to this report within 30 days and provide the information cited on pages 28 through 30 of this report as a basis for closing Recommendations 1.1, 1.2, 3.1, 3.2, 4.1, 4.2, and 5; and for resolving and closing Recommendations 2 and 6.

The representation letter you provided in conjunction with this audit was fully acceptable. As a result, this report contains no qualifying language on the positive aspects of the Mission's performance.

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

P.O. BOX 30261, NAIROBI, KENYA · PHONE: (254-2-331160, EXT 402 FAX (254-2-213551

EXECUTIVE SUMMARY

Background

The overall purpose of the Rwanda Production and Marketing Policy Reform (PMPR) Program is to increase competition in the short run, and subsequently production and employment in manufacturing and related sectors. The Program's purpose is to be achieved through implementation of its four components: (1) a set of policy reforms supporting the Government of Rwanda's (the Government's) own structural reform agenda towards a market-driven system, (2) a $25 million cash transfer to assist with the implementation of the policy reforms contemplated by the Program; (3) local currency generated by the $25 million cash transfer to help reduce Government arrears (debts) to private sector manufacturers, commercial concerns and other private suppliers; and (4) monitoring and institutional strengthening for overseeing and assessing the impact of A.I.D.-supported reforms and associated parts of the larger structural adjustment program on competition, production and employment (see page 1). The cash was to be released in two tranches of $15 million and $10 million upon fulfillment of agreed upon policy reforms. In accordance with the grant agreement, Rwandan Francs (Rwf) 1.8 billion was generated and deposited into a special account on December 31, 1991; the equivalent of $1.05 million (Rwf 125 million) had been disbursed from the special account as of September 1992 (see page 1).

A.I.D's revised policy on local currency is contained in PD-18 dated July 30, 1991. This guidance supersedes both PD-5 of 1983 and the supplemental guidance of 1987. PD-18 describes the generation, management, and programming of host county-owned local currency. The policy, which became effective on July 1, 1991, clarifies circumstances under which local currency is generated and must be deposited and it permits missions to jointly program local currency to help fund a government's deficit or reduce its debt. Most importantly, it adopts accountability standards as explained in State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency", dated June 21, 1991 (see pages 1 and 2).

The PMPR Program was designed during the transition to Policy Determination No. 18 (PD-18) as follows: the Program Assistance Identification Proposal was signed on April 30, 1991, and the Program Assistance Approval Document (PAAD) and the program grant agreement were both signed on September 19, 1991. PMPR's program assistance completion date is June 30, 1993 (see page 2).

Audit Objectives

We audited the PMPR Program in accordance with generally accepted government auditing standards. (See page 2 and Appendix I). The PMPR Program was audited as part of a worldwide audit of host-country owned local currency. Local currency has been a long-recognized area of vulnerability in A.I.D. economic assistance program. The A.I.D. Inspector General and the General Accounting Office have reported on problems with A.I.D. oversight of local currency including management of the special local currency accounts and ensuring that local currencies were used for agreed upon purposes. As a result of these audits, A.I.D. issued detailed guidance to address the weaknesses in oversight and accountability (see page 2). Our field work was conducted from September 21 through November 20, 1992 to answer the following audit objectives:

1. Did USAID/Rwanda assess the accountability environment in the host country as required by A.I.D. policy and supplemental guidance? (See page 5.)

2. Did USAID/Rwanda design the grant agreements and amendments in accordance with A.I.D. policy and the supplemental guidance? (See page 7.)

3. Did USAID/Rwanda ensure that local currency generations were deposited and quickly disbursed as required by A.I.D. policy and supplemental guidance? (See page 9.)

4. Did USAID/Rwanda ensure that local currencies were programmed and used for the intended purposes as required by A.I.D. policy and supplemental guidance? (See page 19.)

5. Did USAID/Rwanda ensure that the impact of the local currency programs will be evaluated in accordance with A.I.D. policy and supplemental guidance? (See page 21.)

Summary of Audit

The audit found that USAID/Rwanda: (1) assessed the accountability environment in the host country, (2) included provision for a special account in the grant agreement, (3) generated and deposited local currency into the special account, (4) adopted the specific-sector programming option which is acceptable under PD-18, and (5) ensured the impact of the Program would be evaluated, in accordance with A.I.D. policy and supplemental guidance.

However, USAID/Rwanda did not (1) design the grant agreement to include provisions for audit; and deposit of all local currency generations into the special account including those resulting from interest on the dollar account, interest bearing accounts and exchange rate fluctuations, and (2) ensure local currency generations were disbursed quickly from the special account and were used for intended purposes, as required by A.I.D. policy and supplemental guidance.

As a result, USAID/Rwanda did not: (1) have reasonable assurance that the local currency equivalent of $25 million (Rwf 3.2 billion) under the Program would be used for intended purposes, (2) ensure an additional local currency equivalent of $1.7 million (Rwf 220 million) was deposited into the special account, (3) ensure the local currency equivalent of $14 million (Rwf 1.6 billion) was quickly disbursed, and (4) ensure that the local currency equivalent of $1.05 (Rwf 125 million) disbursed from the special account was used for intended purposes.

Audit Findings

Assessment of the Accountability
Environment In the Host Country

USAID/Rwanda assessed the accountability environment in the host country as required by A.I.D. policy and supplemental guidance. In March 1991, the USAID conducted a general assessment which concluded that the Government had the capability to budget and disburse funds. This was followed by an informal assessment in July 1991 which supported the conclusions of the general assessment. The basis for conducting an informal assessment, instead of a formal financial assessment, was the positive experience which the USAID had with the Ministry of Finance in the management of a special account under a different program (see pages 5 and 6).

Design of the Grant
Agreement and Amendments

USAID/Rwanda designed the grant agreement and amendments for PMPR in accordance with A.I.D. policy and supplemental guidance by including the provision for a special local currency account. However, USAID/Rwanda did not include audit provisions in PMPR's grant agreement as required by A.I.D. policy and supplemental guidance. As a result, the PMPR Program did not use a primary internal control technique for ensuring that local currency equivalent to the PMPR funding of $25 million (Rwf 3.2 billion) was used for intended purposes (see page 7).

Generation, Deposit and
Disbursement of Local Currency

USAID/Rwanda ensured local currency equivalent to the first tranche of $15 million was deposited into a special account in accordance with A.I.D. policy and supplemental guidance. However, USAID/Rwanda did not ensure local currency generations from interest on the dollar account and interest-bearing accounts were deposited in the special account as required by A.I.D. policy and the supplemental guidance. Further, USAID/Rwanda did not account for additional generations resulting from exchange rate fluctuations and did not ensure local currency generations were disbursed quickly. As a result, the local currency equivalent of $1.7 million (Rwf 220 million) had not been deposited into the special account and was not available for development purposes. Also, only the local currency equivalent of $1.05 million (Rwf 125 million) out of $15 million (Rwf 1.8 billion) under the first tranche had been disbursed from the special account. Unless corrected, these problems will also impact on the second tranche of $10 million (see pages 9, 10, 12, 14 and 16).

Local Currency Programming and Use

USAID/Rwanda ensured that local currencies were programmed as required by A.I.D. policy and supplemental guidance except that it had not performed audits to verify that local currencies were used for intended purposes as required by A.I.D. policy and supplemental guidance. As a result, USAID/Rwanda did not have reasonable assurance that local currency equivalent to $1.05 million (Rwf 125 million) disbursed from the special account was used for intended purposes (see page 19).

Impact Evaluation of the
Local Currency Program

USAID/Rwanda ensured that the impact of the local currency program will be evaluated in accordance with A.I.D. policy and the supplemental guidance. To this end, USAID/Rwanda developed verifiable performance indicators to measure the reduction in Government arrears to domestic creditors (see page 21).

Summary of Recommendations

The report contains six recommendations to correct problem areas identified. First, the report recommends that USAID/Rwanda amend the grant agreement to include provision for audit. Second, the report recommends amendment of the grant agreement to ensure additional local currency generations, estimated to be $870,000, are accounted for and deposited to the special account and made available for joint programming under the second tranche of $10 million. Third, the report recommends amendment of the grant agreement to provide for the deposit of $193,117 in local currency generated from interest on the dollar account into the special account. Fourth, the report recommends that USAID/Rwanda amend the grant agreement to deposit local currency generations into interest bearing accounts or make a written determination not to follow A.I.D.'s preference for interest bearing accounts. Fifth, the report recommends that USAID/Rwanda establish procedures for the disbursement of the local currency equivalent of $14 million from the special account. Sixth, the report recommends that USAID/Rwanda schedule an audit of disbursements from the special local currency account. Finally, the report recommends, that the problems with audit provisions, and deposit of all local currency generations into the special account be reported as material weaknesses in the next Federal Managers' Financial Integrity Act (FMFIA) reporting cycle to the Assistant Administrator Bureau for Africa, if these problems are not corrected (see pages 7, 10, 12, 14, 16, and 19).

Management Comments and Our Evaluation

USAID/Rwanda agreed with most of the draft report's findings and recommendations. However, USAID/Rwanda disagreed with the finding that the Mission is accountable for additional local currency generations resulting from exchange rate fluctuations, and Recommendation No. 2 that the program grant agreement be amended to ensure that these generations are accounted for and deposited to the special account and made available for joint programming. USAID/Rwanda makes arguments for their interpretation of PD-18. The Mission's interpretation is based on considerations other than maximum deposits. Our position is that the issue is not maximum deposits but accountability for all local currency generations. Therefore, we believe the design of the program agreement should have considered the potential for additional local currencies being generated by the sale of dollars at higher rates of exchange than the rate used by the Government to make the initial deposit of local currency in the special account.

Regarding Recommendation No. 6, USAID/Rwanda took exception to the statement that the Mission did not have reasonable assurance that the local currency equivalent $1.05 million (Rwf 125 million) disbursed from the special account was used for intended purposes. It is our opinion that the Mission will not have reasonable assurance that the local currencies were used for intended purposes until an audit is conducted and the findings support the Mission's position. Also, we believe that the continuing civil war in Rwanda increases the risk that local currencies could be used for activities prohibited by Congressional legislation including law enforcement and military or paramilitary purposes. Our review of a sample of payment vouchers disclosed several payments whose eligibility was questionable. Finally, USAID/Rwanda disagreed with the statement that "all" disbursements from the special account should be audited. Audit of "all" disbursements does not mean that sampling techniques would not be used; it simply means that all disbursements will be included in the audit universe and would be eligible for selection.

USAID/Rwanda's comments to the draft report were considered in preparing the final report. Recommendation Nos. 1.1, 1.2, 3.1, 3.2, 4.1, 4.2, and 5 are resolved but not closed. Recommendation Nos. 2 and 6 are unresolved (see pages 28 through 30 and Appendix II).

The reports on internal controls and compliance are found on pages 22 and 26, respectively.

Office of the Inspector General

Office of the Inspector General
March 19, 1993

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INTRODUCTION

Background

The purpose of the Rwanda Production and Marketing Policy Reform (PMPR) Program is to increase competition in the short run, and subsequently production and employment, in manufacturing and related sectors. The Program's purpose is to be achieved through the implementation of its four components:

- The first component is a set of policy reforms supporting the Government of Rwanda's (the Government's) own structural reform agenda towards a market-driven system. These reforms focus on the foreign exchange allocation and import system, the restrictive trade regime, and the number of prices under government control.

- The second component is a $25 million cash transfer to assist with the implementation of the policy reforms contemplated by the Program. The dollar funds will help reduce real and perceived risks and uncertainties associated with the change from the current administratively-allocated import system to the market-driven system. The funds were to be released in two tranches of $15 million and $10 million upon fulfillment of agreed upon policy reforms. According to a financial report provided by USAID/Rwanda, $25 million in A.I.D. funds was obligated and $15 million of the program assistance had been disbursed to the Government as of October 28, 1992.

- The third component is the local currency generated by the $25 million cash transfer to help reduce Government arrears (debts) to private sector manufacturers, commercial concerns, and other private suppliers. According to records available at USAID/Rwanda, Rwanda Francs (Rwf) 1.8 billion was generated and deposited into a special account on December 31, 1991; the equivalent of $1.05 million (Rwf 125 million) had been disbursed from the special account as of September, 1992.

- The fourth component involves monitoring and institutional strengthening for overseeing and assessing the impact of A.I.D.-supported reforms and associated parts of the larger structural adjustment program on competition, production and employment.

A.I.D's revised policy on local currency is contained in Policy Determination No. 18 (PD-18), dated July 30, 1991. This guidance supersedes both PD-5 of 1983 and the supplemental guidance of 1987. The PD-18 describes the generation, management, and programming of host county-owned local currency. The policy, which became effective on July 1, 1991, clarifies circumstances under which local currency is generated and must be deposited and it permits missions to jointly program local currency to help fund a government's deficit or reduce its debt. Most importantly, it adopts accountability standards as explained in State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency", dated June 21, 1991.

The accountability standards for host country-owned local currency are particularly important to the achievement of A.I.D.'s objectives for local currency. These standards (1) define mission responsibility in programming and managing local currency, (2) contain specific requirements for managing local currency special accounts, including assessing host government capabilities to manage special accounts, and (3) provide guidelines for assuring that local currencies disbursed from the special accounts were used for agreed upon purposes. The accountability standards also include requirements for host government reporting, mission oversight, audits, and evaluations.

The President's Commission on the Management of A.I.D. Programs recommended that A.I.D. carefully monitor how missions and overseas offices implement A.I.D.'s July 1991 guidance on local currency and evaluate whether or not the new procedures are successful.

The PMPR Program was designed during the transition to PD-18 as follows: the Program Assistance Identification Proposal was signed on April 30, 1991, and the Program Assistance Approval Document (PAAD) and the program grant agreement were both signed on September 19, 1991. The PMPR's program assistance completion date is June 30, 1993.

Audit Objectives

The Office of the Regional Inspector General for Audit/Nairobi audited USAID/Rwanda's Management of Host Country-Owned Local Currency (specifically, USAID/Rwanda's Production and Marketing Policy Reform Program) in accordance with generally accepted government auditing standards. The PMPR Program was audited as part of a worldwide audit of host-country owned local currency. Local currency has been a long-recognized area of vulnerability in A.I.D. economic assistance programs. The A.I.D. Inspector General and the General Accounting Office have reported on problems with A.I.D. oversight of local currency including management of the special local currency accounts and ensuring that local currencies were used for agreed upon purposes. As a result of these audits, A.I.D. issued detailed guidance to address the weakness in oversight and accountability.

USAID/Rwanda was selected for audit because it was one of those missions which were further along in implementing the new policy. The PMPR was selected for audit because it was the only non-project assistance agreement in USAID/Rwanda signed after July 1, 1991, the date PD-18 and the supplemental guidance became effective. Our field work was conducted from September 21 through November 20, 1992 to answer the following audit objectives:

1. Did USAID/Rwanda assess the accountability environment in the host country as required by A.I.D. policy and supplemental guidance?

2. Did USAID/Rwanda design the grant agreements and amendments in accordance with A.I.D. policy and supplemental guidance?

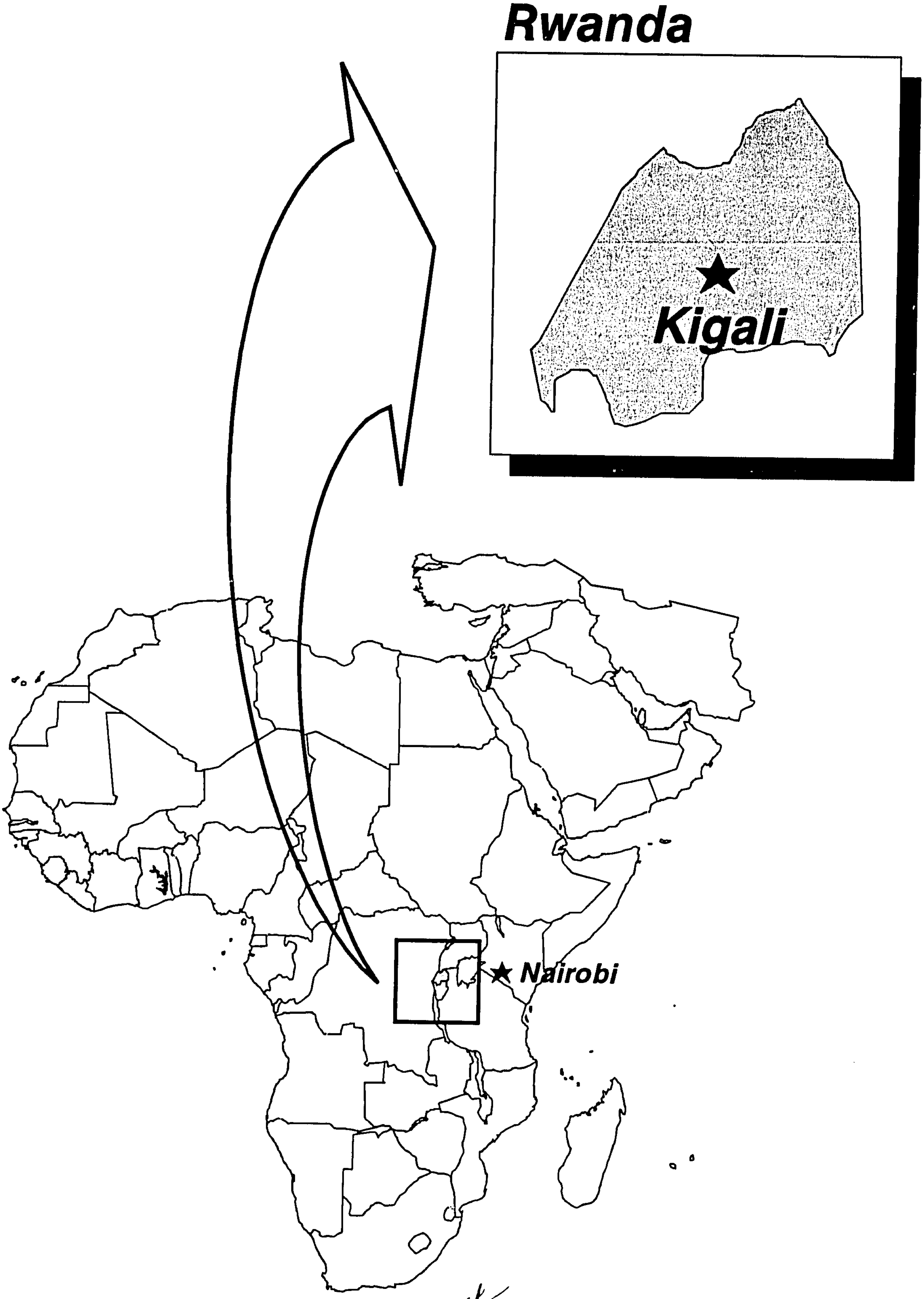
3. Did USAID/Rwanda ensure that local currency generations were deposited and quickly disbursed as required by A.I.D. policy and supplemental guidance?

4. Did USAID/Rwanda ensure that local currencies were programmed and used for the intended purposes as required by A.I.D. policy and supplemental guidance?

5. Did USAID/Rwanda ensure that the impact of the local currency programs will be evaluated in accordance with A.I.D. policy and supplemental guidance?

In answering these audit objectives, we tested whether USAID/Rwanda (1) followed applicable internal control procedures in PD-18 and the supplemental guidance and (2) complied with certain provisions of laws and regulations. Our tests were sufficient to provide reasonable -- but not absolute -- assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. Where we found problems, we determined the cause and effect of the problems and made recommendations for corrective action.

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


Rwanda
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REPORT OF AUDIT FINDINGS

Did USAID/Rwanda assess the accountability environment in the host country as required by A.I.D. policy and supplemental guidance?

USAID/Rwanda assessed the accountability environment in the host country as required by A.I.D. policy and supplemental guidance.

Section 2 of State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency" (which explains new accountability standards for managing local currency adopted by Policy Determination No.18) requires an assessment of the general accountability environment in the host country in order to ensure accountability for host country-owned local currency. Missions are required to examine factors such as the: (1) general financial management capabilities of the host government, (2) quality of accounting and financial management personnel within the host government, (3) systems in place to allocate and expend funds, (4) external economic factors which might influence the use of local currency, and (5) mission's prior experience with ensuring accountability for A.I.D. resources and local currency in that country. Section 2.5 requires each Program Assistance Approval Document (PAAD) to include as part of the financial analysis section a detailed specific assessment of appropriate programming alternatives available to the mission based on the general assessment.

According to Section 5.1.A.1 of State cable No. 204855, USAID offices should conclude on the capability of the host country's implementing agency to manage the special account. If an agency or host government unit which has not previously managed a special account is to be responsible, a formal financial assessment should be performed. Also, if a host government agency has managed a special account previously and has a poor record as indicated by things such as negative audits or untimely, incomplete or inaccurate reports, then a formal financial assessment should be performed. That is, the accounting and financial systems should be reviewed in order to determine whether sufficient personnel, systems, and internal controls exist to adequately manage the special account. However, if the designated host government agency has experience in managing special accounts, then the mission may choose to rely on an informal assessment.

As required by State cable No. 204855, USAID/Rwanda conducted in March 1991 a general assessment of the methods of implementation and financing used by the Government, reviewed from a standpoint of accountability. On the basis of this general assessment, the PAAD for the Production and Marketing Policy Reform (PMPR) Program dated September 19, 1991 concluded that the Government of Rwanda --through the Ministry of Finance and the National Bank of Rwanda --had the capability to budget and disburse funds. Further, the conclusion in the PAAD stated that the Government's budgeting and disbursements process is closely managed by the

Ministry of Finance and, in turn, the Ministry's work is closely reviewed by several other Government bodies including a committee comprised of all the Government ministers.

In July 1991, USAID/Rwanda conducted an informal assessment which supported the conclusions of the general assessment. The basis for conducting an informal assessment, instead of a formal financial assessment, was the positive experience which the USAID had with the Ministry of Finance in the management of a special account under a different program. The informal assessment stated that the Government's strength was in budgeting and controlling disbursements because the Ministry of Finance controls all financial transactions from budgeting to commitment of funds to actual disbursement and subsequent reporting for all Government of Rwanda monies. Therefore, the informal assessment concluded that the Ministry of Finance could manage the specific sector support, in the form of debt relief, proposed under PMPR.

USAID/Rwanda did not document the justification for opting to conduct an informal assessment, in PMPR's PAAD. However, we did not consider this omission significant to the implementation of the program since USAID/Rwanda had otherwise complied with A.I.D. policy and supplemental guidance in assessing the accountability environment in the host country.

Did USAID/Rwanda design the grant agreements and amendments in accordance with A.I.D. policy and supplemental guidance?

USAID/Rwanda designed the grant agreement and amendments for the Production and Marketing Policy Reform (PMPR) Program in accordance with A.I.D. policy and supplemental guidance except that the provisions for audit and for deposit of all local generations into the special account were not included in PMPR's grant agreement as required by A.I.D. policy and supplemental guidance.

Section 4.2 of Policy Determination No. 18 states that, if generated, local currency must be deposited into a separate account for joint programming. Further, State cable No. 204855 (Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency) requires the establishment of a local currency special account when an A.I.D. agreement results in the generation of local currencies. USAID/Rwanda included provision for a special account in PMPR's grant agreement. A special account was opened at the Central Bank of Rwanda and on December 31, 1991, Rwanda Francs 1.8 billion was deposited into the account. Another positive aspect was the inclusion of performance indicators in the grant agreement as discussed under Audit Objective Five.

However, as discussed below USAID/Rwanda did not include provisions for audit. Other problems associated with the generation of local currencies, the deposit of local currency generated by the interest earned on the dollar account, and the deposit of local currencies in an interest-bearing account are discussed under Audit Objective Three.

USAID/Rwanda's Production and Marketing Policy
<u>Reform Program did not Include Provisions for Audit</u>

USAID/Rwanda did not include audit provisions in the Program Assistance Approval Document (PAAD) or the grant agreement for the PMPR Program as required by A.I.D. policy. This occurred because USAID/Rwanda officials believed the provisions for audit had been adequately addressed in the design documents for other related projects even though they had not been. As a result, the PMPR Program did not use a primary internal control technique for ensuring that local currency equivalent to $25 million (Rwf 3.2 billion) was used for intended purposes.

<u>Recommendation No. 1:</u> We recommend that USAID/Rwanda:

1.1 Amend the program agreement for the Production and Marketing Policy Reform Program to include the provisions for audit.

1.2 Report in the next Federal Managers' Financial Integrity Act reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with

USAID/Rwanda's provisions for audit in the program grant agreement, if this weakness is not corrected.

According to Section 5.1.C of State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency," missions should discuss with the host government at the PAAD stage the requirements with regard to auditing the special account. In addition the program agreement should contain specific language concerning audit responsibilities, frequency, and funding. Furthermore, program agreements must reserve audit rights in the U.S. and state that A.I.D. audit rights will not be subordinated or infringed by arrangements for audits by the host country or outside auditors. However, the PAAD for USAID/Rwanda's PMPR Program did not contain evidence that the Mission discussed with the Government the requirement for auditing the special account. Furthermore, the grant agreement for PMPR did not contain the required audit provision.

USAID/Rwanda did not include audit provisions in the PMPR PAAD and program agreement because the Mission believed the audit provisions had been made in design documents for other related projects. However, our review of these documents found no specific reference to audit of the PMPR special account. In addition, Mission officials stated that the PAAD for the PMPR was reviewed by AID/Washington's Executive Committee Project Review which did not question the absence of the provision for audit. Thus, USAID/Rwanda officials believed the lack of audit provisions in the PAAD for the PMPR was acceptable to the Committee. However, we believe the primary responsibility for ensuring planning documents contain all required provisions lies with the Mission and not with AID/W's Executive Committee Project Review.[1]

--- USAID/Rwanda's management did not include a primary internal control technique for ensuring that local currency equivalent to $25 million (Rwf 3.2 billion) was used for intended purposes ---

As a result of the foregoing, USAID/Rwanda's management did not include a primary internal control technique for ensuring that local currency equivalent to $25 million (Rwf 3.2 billion) was used for intended purposes.

Based on the above, we concluded that USAID/Rwanda needed to amend PMPR's program grant agreement to include provision for audit. Furthermore, the lack of audit provision in the program grant agreement should be reported as a material weakness in the next Federal Managers' Financial Integrity Act reporting cycle to the Assistant Administrator, Bureau for Africa, if the problem is not corrected.

[1]This is based on our interpretation of the Supplemental Guidance on Programming and Managing Host-Country Owned Local Currency. We believe this is a reasonable interpretation.

Did USAID/Rwanda ensure that local currency generations were deposited and quickly disbursed as required by A.I.D. policy and supplemental guidance?

USAID/Rwanda ensured local currency equivalent to the first tranche of $15 million was deposited into a special account in accordance with A.I.D. policy and supplemental guidance. However, USAID/Rwanda did not ensure that all local currencies generated were accounted for and deposited in the special account and made available for joint programming. In addition, local currency generations were not disbursed quickly from the special account.

Section 4.2 of Policy Determination No. 18 states that, if generated, local currency must be deposited into a special account for joint programming. In accordance with this policy, the grant agreement required the Government of Rwanda (the Government) to immediately deposit an equivalent amount of local currency into a special local currency account at the Central Bank of Rwanda upon receiving notification that the dollar funds had been transferred into the Government's dollar account at Citibank, New York. The applicable exchange rate was to be the rate at the time the funds were transferred into the dollar account. The first tranche of $15 million was transferred to the Citibank account on December 24, 1991 and in accordance with the grant agreement the Government deposited Rwf 1.8 billion on December 31, 1991 at the Central Bank of Rwanda using the rate ruling on December 24, 1991.

However, USAID/Rwanda did not ensure that: (i) additional generations resulting from exchange rate fluctuations were deposited into the special account and made available to the PMPR Program, (ii) local currency generations from interest on the dollar account were deposited into the special account, (iii) local currency generations were deposited into interest-bearing accounts, and (iv) local currency generations were disbursed quickly from the special account.

These problems are discussed below.

Additional Local Currency Generations
Could Have Been Available for Development

A.I.D. policy requires missions and the host countries to deposit into a special account and jointly program all local currency generations. However, under USAID/Rwanda's Production and Marketing Policy Reform (PMPR) Program, some local currency generations were not deposited in the special account nor made available for joint programming. This occurred because, at the design phase, USAID/Rwanda did not establish provisions to account for additional local currency generations resulting from exchange rate fluctuations. As a result, the equivalent of $1.3 million in additional local currency generated under the first tranche of $15 million was not deposited in the special account and was not available for development purposes.

Unless corrected, an estimated $870,000[2] generated under the second tranche of $10 million may not be deposited and programmed.

> **<u>Recommendation No. 2:</u> We recommend that USAID/Rwanda amend the program grant agreement to ensure that additional local currency generations, estimated to be $870,000, are accounted for and deposited to the special account and made available for joint programming under the second tranche of $10 million.**

Section 4 of A.I.D. Policy Determination No. 18 requires local currency generations to be deposited into a special account for joint programming by A.I.D. and the host country. Also, Section 3.1 of State Cable No. 204855 (the Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency) states that A.I.D. and the host government must specify in the grant agreement the total amount of the dollar assistance which will generate local currency and the exchange rate that will be used to express that amount in terms of local currency. The agreement should also determine when the local currency deposits will be made during the life of the agreement. Furthermore, major fluctuations in the host government exchange rate must be accounted for through appropriate agreement provisions to allow revisions to the agreed upon local currency amount.

For the purposes of this audit, we defined accounting for exchange rate fluctuations to include considerations of:

- -- past trends of host country's currency fluctuations,
- -- the current state of the host country's economy, and
- -- the expected future state of the host country's economy.[3]

The grant agreement for USAID/Rwanda's PMPR Program required the Government of Rwanda to deposit the entire local currency equivalent of $15 million under the first tranche release on December 24, 1991, using the exchange rate of 118.7359 on that date. This resulted in Rwandan francs (Rwf) 1,781,038,500 being deposited into the special account. However, the dollar account was actually drawn down over an extended period, during which period the

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[2]The assumption in the computation of additional generations for the second tranche is that the movement in the rate of exchange and the rate at which funds will be disbursed from the special account will be the same as for the first tranche. Thus, the level of additional generations will be proportionate to the first tranche.

[3] This definition is based on our interpretation of section 3.1 of the Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency which states that major fluctuations in the host government exchange rate must be accounted for through appropriate agreement provisions.

Government of Rwanda sold the dollars to local importers using higher exchange rates. Because of fluctuations of the Rwandan Franc, the Government of Rwanda sold the dollars to the importers using exchange rates ranging between 120.798 and 141.169. Thus, the local currency equivalent of $1.3 million was generated but not deposited into the special account to be jointly programmed by USAID/Rwanda and the Government.

According to Section III, of the Program Assistance Approval Document (PAAD) for the PMPR, the Rwandan currency was devalued by 40 percent in November 1990 -- about 1 year before the PAAD was approved. According to a USAID/Rwanda official, the Rwanda currency was again devalued in June 1992 by 17 percent. Furthermore, we were informed that the Rwandan economy started deteriorating from October 1990 because of the war and these factors should have indicated that there would be currency exchange rate fluctuations. Thus, we believe USAID/Rwanda should have considered the consequences of such fluctuations when estimating the amount of local currency to be generated, the rate of exchange to be applied, and the time to deposit the local currency.

The above problem occurred because USAID/Rwanda did not establish agreement provisions that would account for the effect of exchange rate fluctuations on the local currency generations under the PMPR Program. While it is not always possible to anticipate currency fluctuations, provisions can be placed in agreements that take fluctuations into account. Given the situation in Rwanda -- past currency devaluation, state of the economy, and future expectations -- it would have been prudent to have provisions for ensuring that any additional local currency generations be accounted for and deposited into the special account when generated.

As a result of the foregoing, the equivalent of $1.3 million in local currency generations under the first tranche of $15 million was not deposited into the special account and was not available for joint programming by USAID/Rwanda and the Government of Rwanda. Furthermore, since this money was out of USAID/Rwanda's control, it could be used for other than intended purposes, including military, paramilitary, or police activities, which are specifically prohibited by legislation. More importantly, unless corrected, the equivalent of an estimated $870,000 under the second tranche of $10 million will not be deposited and available to be programmed for development purposes within Rwanda.

--- the equivalent of $1.3 million in local currency generations under the first tranche of $15 million was not deposited into the special account and was not available for joint programming ---

Based on the above, we concluded that USAID/Rwanda needed to amend the grant agreement to include provisions which will account for all counterpart funds generated under the second tranche of $10 million.

Provision to Deposit Local Currency Generated
by Interest on the Dollar Account was not Made

A.I.D. policy requires all local currencies generated by U.S. dollar disbursements to be deposited in a special account. However, interest earned on the Government of Rwanda's dollar account was not programmed or deposited to the special account. This occurred because USAID/Rwanda officials did not include a provision in the grant agreement to ensure local currency generated by interest on the dollar account was deposited into the special account. As a result, the local currency equivalent of $193,117 -- interest earnings for the period January to August 1992 under the first tranche of $15 million -- has not been deposited into the special account. Unless corrected, this problem will also impact on interest earnings estimated at $128,745,[4] on the dollar account under the second tranche of $10 million.

> Recommendation No. 3: **We recommend that USAID/Rwanda:**
>
> **3.1 Amend the program agreement for the Production and Marketing Policy Reform Program to provide for the deposit of $193,117 in local currency generated by the interest earned on the dollar account (as well as future earnings estimated at $128,745) into the local currency special account.**
>
> **3.2 Report in the next Federal Managers' Financial Integrity Act reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with grant agreement provisions for the generation of local currency from interest on the dollar amount if this weakness is not corrected.**

Section 4 of A.I.D. Policy Determination No. 18 requires local currency generations to be deposited into a special account for joint programming by A.I.D. and the host country. According to this section, local currency is generated when the use of the Foreign Assistance Act dollar disbursements results in the receipt of local currency by the recipient government, and when A.I.D. requires a deposit or set aside of local currency by the recipient government as a condition or term of the assistance agreement. For the purpose of this audit, we defined disbursements to include:

-- the principal amount of U.S. dollars provided to the recipient, and

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[4] We have assumed that the period of deposit and the rate of interest under the first tranche will apply to the second tranche. Thus, interest earnings will be proportionate.

-- any interest earnings on the principal amount of dollars provided[5].

However, the grant agreement for USAID/Rwanda's Production and Marketing Policy Reform (PMPR) Program did not provide for the deposit of local currency generated by the interest earned on the dollar account into the local currency special account. According to page 8 of Annex 1 to the program agreement on generation of local currency, upon the release of the dollar funds the Government of Rwanda would immediately deposit into a local currency special account an equivalent amount of local currency. However, the program agreement was silent on the local currency to be generated by the interest earnings on the dollar account.

According to USAID/Rwanda officials, the Government of Rwanda initially wanted interest on the dollar account to be out of the program -- and thus out of USAID/Rwanda's control -- but later agreed to have the interest as part of the program. However, since the Mission did not ensure that the grant agreement addressed this issue, interest earnings on the dollar account was still out of the program. For example, as of the date of the audit local currency generated by the interest earnings on the dollar account had not been deposited into the local currency special account.

This occurred because, at the design stage, USAID/Rwanda officials did not consider the issue of generating local currency from interest on the dollar account. As such, these officials did not include a provision for the local currency to be generated by the interest earnings on the dollar account in the grant agreement.

--- the local currency equivalent of $193,117 --- interest earnings for the period January to August 1992 under the first tranche of $15 million --- had not been deposited into the special account by the time of the audit ---

As a result, the local currency equivalent of $193,117 -- interest earnings for the period January to August 1992 under the first tranche of $15 million -- had not been deposited into the special account by the time of the audit. Thus, these generations were not available to be used for development purposes in Rwanda and could therefore be used for other than intended purposes. Unless corrected, this problem will also likely impact on interest on the dollar account under the second tranche of $10 million.

Based on the above, we concluded that USAID/Rwanda needed to amend PMPR's grant agreement to provide for deposit into the special account of local currency generated by interest on the dollar account.

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[5] This definition is based on our interpretation of joint programming procedures as outlined in section 5 of PD-18. Section 5.6 requires interest earned on local currency special accounts to be programmed as if it were the principal. We believe that the interest earned on the dollar account should also be available for programming as if it were the principal.

Additional Program Funds Could be Generated
<u>From Interest Bearing Local Currency Accounts</u>

According to A.I.D. policy, local currency generations should be deposited in interest bearing accounts whenever possible. However, local currency funds under USAID/Rwanda's Production and Marketing Policy Reform (PMPR) Program were not deposited into interest bearing accounts. This occurred because USAID/Rwanda officials did not include a provision for interest bearing accounts in the grant agreement and had not made a written determination not to follow A.I.D.'s preference for interest bearing accounts. As a result, an estimated Rwf 22,129,240 ($167,112) in interest was not earned nor available to be used for development purposes in Rwanda. If funds are now placed in interest bearing accounts, about Rwf 37,537,500 ($262,500) could still be realized.

<u>Recommendation No. 4:</u> **We recommend that USAID/Rwanda:**

4.1 Amend the Production and Marketing Policy Reform Program grant agreement by requiring the Government of Rwanda to deposit local currency generations into interest bearing accounts or make a written determination not to follow A.I.D.'s preference for interest bearing account.

4.2 Report in the next Federal Managers' Financial Integrity Act reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with USAID/Rwanda's deposit of local currency in non-interest bearing accounts, if this weakness is not corrected.

Section 5.6 of A.I.D. Policy Determination No. 18 and Section 5.2 of State Cable No. 204855 dated June 21, 1991 (the Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency) recommends that local currency be placed into interest-bearing accounts in deposit-taking institutions, with any interest earned programmed as if it were the principal, so long as such accounts are permitted under host country laws and regulations and do not undermine internationally-supported stabilization agreements and sound monetary policy. Furthermore, a written determination not to follow A.I.D.'s preference for interest-bearing accounts is to be made by the Mission Director and copies of each determination are to be retained by the Mission.

The local currency funds generated by USAID/Rwanda's PMPR Program were deposited in a non-interest bearing account in the National Bank of Rwanda. On December 31, 1991, Rwf 1,781,038,500 ($15 million) was deposited into this special account and at the time of our audit (in September) approximately Rwf 1,655,854,960 (about $13.9 million) was still held in a non-interest bearing account. USAID/Rwanda did not make a written determination not to follow A.I.D.'s preference for interest bearing account.

Local currency generated under the PMPR Program was held in a non-interest bearing account because USAID/Rwanda officials did not include a provision for an interest bearing account in the grant agreement. According to USAID/Rwanda officials, it was expected that the funds would be disbursed fairly quickly and as such an interest bearing account would not be necessary. However, we believe that the prudent thing to do would have been to deposit the funds in an interest bearing account regardless of whether or not such funds would be disbursed quickly. As stated in PD-18, disbursement delays occur unavoidably and, hence, the recommendation for interest bearing accounts.

--- the local currency from the first tranche release of $15 million remained idle in a non-interest bearing account for almost one year ---

USAID/Rwanda officials further stated that AID/W transferred $15 million to Citibank in New York City and then the Government of Rwanda deposited the local currency equivalent of $15 million as an advance to the special account. Those officials believed that it would have been inappropriate to require the funds to be placed in an interest bearing account since it would amount to the Government paying interest on funds it had already tied-up. However, we believe it did not make any difference whether the local currency was deposited up-front or on a transaction by transaction basis.

As a result of the foregoing, the local currency from the first tranche release of $15 million remained idle in a non-interest bearing account for almost one year -- between January through November 1992. If these funds had been deposited in an interest bearing account at the time it was generated in December 1991, an estimated Rwf 22,129,240 ($167,112) could have been earned as interest based on 4.5 percent interest, which was an average of interest rates offered to Rwandan depositors by three banks. In addition, if the local currency generations from the second tranche of $10 million are deposited into an interest bearing account and remain idle for 7 months we estimate that interest earnings of Rwf 37,537,500 ($262,500)[6] could be earned assuming 4.5 percent interest.

Based on the above, we concluded that USAID/Rwanda needed to amend the grant agreement to provide for deposit of local currency generations, into interest bearing accounts or make a written determination not to follow A.I.D.'s preference for interest bearing accounts. In addition, we consider this to be a material weakness and a reportable condition under the Federal Managers' Financial Integrity Act, if the problem is not corrected.

[6]Computation of interest earnings from the second tranche is based on the assumption that the rate of disbursement from the special account will remain unchanged up to the program assistance completion date on June 30, 1993. Also, there will be no material change to the rate of interest on deposits in Rwanda.

Local Currencies Have
not Been Disbursed Quickly

According to A.I.D. policy, programmed local currency should be disbursed quickly. However, the Government of Rwanda has not disbursed local currencies deposited in the special account quickly. This occurred because the Government used its own resources and local currency from other donors to pay most of the eligible arrears to domestic creditors. As a result, local currency equivalent to $14 million has not been disbursed under the first tranche. Also, there is no assurance that the Government will be able to disburse, for intended purposes, the local currency deposits under the second tranche of $10 million.

By the time of the audit, USAID/Rwanda had identified this disbursement problem and initiated corrective action through Project Implementation Letter (PIL) No. 7 to relax the eligibility criteria for government arrears to domestic creditors. At the end of audit field work, PIL No. 7 was at the draft stage being reviewed by the Regional Legal Advisor (RLA) in Nairobi.

> Recommendation No. 5: **We recommend that USAID/Rwanda amend the eligibility criteria for the disbursement of the local currency equivalent of $14 million remaining in the special account.**

Section 5.6 of A.I.D. Policy Determination No. 18 states that programmed local currency should be disbursed as quickly as is consistent with sound programming and prevailing economic conditions in the recipient country. For the purposes of this audit, we define quick disbursement to be payments within 6 months.[7]

The Production and Marketing Policy Reform (PMPR) Program, signed on September 19, 1991, included the agreement to use the local currency associated with the PMPR dollars to clear the Government of Rwanda accumulated arrears towards private enterprises. Eligible arrears were those that were:

- incurred prior to December 31, 1990,
- made to companies, including financial institutions, where the Government's participation was less than 25 percent, with the priority of reimbursement being given to 100 percent private enterprises, then those with the lowest level of Government participation, and
- eligible for reimbursement with respect to A.I.D.'s overall policy considerations. Examples of ineligible arrears include those for police, military, or paramilitary expenses, for abortion equipment,

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[7] This definition is our own. It was based on the 6-month period of time the grant agreement specified to complete the disbursement of the local currency equivalent of $15 million.

for expropriation, and so forth.

The disbursement of the first tranche of $15 million was executed in December 1991. The Government of Rwanda credited the special local currency account with the Rwandan Francs (Rwf) equivalent of $15 million. However, the Government of Rwanda has not disbursed local currencies deposited in the special account quickly. As of September 17, 1992, the Government had disbursed the local currency equivalent of only $1.05 million (Rwf 125 million or about 7% of the amount available for development purposes).

An October 22, 1991 USAID/Rwanda memorandum -- about one month after signing the Program Assistance Approval Document (PAAD) for the PMPR -- stated that the Government had reduced its arrears from $58 million to just $12 million. Thus, USAID/Rwanda should have known there would be problems disbursing the local currency from the special account at least two months before A.I.D. deposited the $15 million into the Government's account at Citibank in New York City on December 24, 1991. USAID/Rwanda officials attributed the slow disbursement to the fact that the Government of Rwanda had reduced most of the eligible arrears, which PMPR Program could have partially financed, using its own resources and local currency from other donors.

As a result, local currency equivalent of $14 million has not been disbursed under the first tranche. Also, there is no assurance that the Government will be able to disburse, for intended purposes, the local currency deposits under the second tranche of $10 million.

--- local currency equivalent of $14 million has not been disbursed under the first tranche. Also, there is no assurance that the Government will be able to disburse, for intended purposes, the local currency deposits under the second tranche of $10 million ---

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Based on the above, we concluded that USAID/Rwanda needed to take appropriate action to have the local currency equivalent of $14 million disbursed from the special account. By the time of the audit, USAID/Rwanda had identified this problem and initiated corrective action through PIL No. 7. However, the PIL had not been approved by the end of audit field work on November 20, 1992. PIL No. 7 will modify the eligibility criteria to reimburse:

(a) Government arrears to enterprises which have up to 75 percent government participation, while maintaining first priority for those firms which have higher levels of private participation,

(b) Government arrears to financial institutions, which have up to 75 percent government participation, for development bonds (and associated interest) whose due date falls within the due date for arrears eligible under PMPR, but which were renewed by the government because of its inability to repay them,

(c) Government for payments made from its own resources before the signing of the Grant Agreement and which were eligible under PMPR conditions, and

(d) arrears incurred in 1991 which meet the eligibility criteria established in the program grant agreement, as amended.

It is expected that the modified criteria will result in quick disbursement of the equivalent of $14 million (Rwf 1.6 billion) remaining in the special account from the first tranche of $15 million.

Did USAID/Rwanda ensure that local currencies were programmed and used for the intended purposes as required by A.I.D. policy and supplemental guidance?

USAID/Rwanda ensured that local currencies were programmed as required by A.I.D. policy and supplemental guidance but had not scheduled audits to verify that local currencies were used for intended purposes as required by A.I.D. policy and supplemental guidance.

According to Section 6.1 of State cable No. 204855 (the Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency), local currency generations can be programmed for budget support (which includes general budget support, general sector support, and specific sector support) and extra-budgetary activities (which includes projects or activities funded outside of the host country's budget). USAID/Rwanda programmed all local currency generations for specific sector support for the entire program in accordance with A.I.D. policy.

However, USAID/Rwanda had not scheduled audits to ensure that local currencies were used as intended. The problem with the use of local currencies is discussed below.

USAID/Rwanda Does not Have Reasonable Assurance that Local Currencies Were Used for Intended Purposes

According to A.I.D. policy, missions should ensure that special accounts are audited periodically. However, USAID/Rwanda had not scheduled audits to verify that local currencies were used for authorized purposes. This occurred because USAID/Rwanda did not include audit provisions in the grant agreement and the Program Assistance Approval Document (PAAD) as required by the supplemental guidance. As a result, USAID/Rwanda did not have reasonable assurance that the local currency equivalent of $1.05 million (Rwf 125 million) was used for intended purposes.

> **Recommendation No. 6: We recommend that USAID/Rwanda schedule an audit of all the disbursements of funds from the special account to ensure that the payments made met the eligibility criteria.**

According to Section 5.1.C of State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency," missions should ensure that special accounts are audited periodically. At the PAAD stage, missions should discuss with the host government the requirements with regard to auditing the special account, and the subsequent program agreement should contain specific language concerning audit responsibilities, frequency, and funding. Furthermore, program agreements must reserve audit rights in the U.S. and state that A.I.D. audit rights will not be subordinated or infringed by arrangements for audits by the host country or outside auditors.

However, USAID/Rwanda had not scheduled any audits of the local currency special account to verify that local currencies have been used for authorized purposes.

This occurred because USAID/Rwanda did not include audit provisions in the PAAD for the Production and Marketing Policy Reform (PMPR) Program and in the program agreement. In addition, AID/Washington's Executive committee Project Review did not question the absence of audit provisions when it reviewed the PAAD for the PMPR. Thus, USAID/Rwanda officials believed the lack of audit provisions was acceptable to the Committee. Furthermore, USAID/Rwanda officials stated that the audit provision for PMPR had been included in the Mission's audit plan to RIG/A/N, and as such they did not believe there was a problem in not having audit provisions in the program documents. However, as discussed under Audit Objective two, we believe the Mission has the primary responsibility for ensuring compliance with A.I.D. policy regarding audit provisions. Also, we believe that including provisions for audit in the program documents is an effective control for ensuring audits are actually done.

--- USAID/Rwanda did not have reasonable assurance that the local currency equivalent of $1.05 million (Rwf 125 million) disbursed from the special account as of September 17, 1992 was used for intended purposes---.

As a result of not providing for audit, USAID/Rwanda did not have reasonable assurance that the local currency equivalent of $1.05 million (Rwf 125 million) disbursed from the special account as of September 17, 1992 was used for intended purposes. Our review of a sample of payment vouchers at the Ministry of Finance disclosed several payments whose eligibility was questionable. Ineligible payments included repair of police cars, expenses for the Ministry of Justice which has the Department of Prisons under it, overseas medical treatment for the children of military personnel, and repair of residential houses occupied by military personnel. This review covered Rwf 99,441,814 ($751,071)[8] in payments and disclosed that at least Rwf 5,971,570 ($45,102) or 6% of our sample were questionable. By the time the entire Rwf 1.8 billion ($15 million) is disbursed, we estimate that Rwf 101 million[9] ($759,063) in questionable payments will have been made.

Based on the above, we concluded that USAID/Rwanda needed to schedule an audit to cover all disbursements from the special account.

[8] The average exchange rate from January 1992 to July 1992 of Rwanda Franc (Rwf) 132.4 = 1 U.S. dollar has been used to convert these disbursements.

[9]The above Rwf 5.9 million in questionable payments constitute 6% of Rwf 99 million reviewed out of Rwf 125 million in disbursements up to the time of the audit. We have applied 6% to the remaining Rwf 1.6 billion to arrive at Rwf 101 million expected questionable payments. We acknowledge that this estimate was not based on the results of a statistical sample and therefore, is only intended to quantify the impact on undisbursed funds.

Did USAID/Rwanda ensure that the impact of the local currency programs will be evaluated in accordance with A.I.D. policy and supplemental guidance?

USAID/Rwanda ensured that the impact of the local currency program will be evaluated in accordance with A.I.D. policy and the supplemental guidance.

According to Section 7.1 of State cable No. 204855 (the Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency), missions are expected to develop, in collaboration with the host country, performance indicators to guide their programming of local currency by measuring the tangible results of the program. The performance indicators must be written in such a way that they are verifiable. USAID/Rwanda developed performance indicators and included them in the grant agreement to measure the reduction in Government arrears to domestic creditors by the equivalent of $15 million by June 30, 1992 and by the equivalent of $25 million by December 31, 1992.

The Production and Marketing Policy Reform (PMPR) Program is part of an overall program of structural adjustment being undertaken by the Government of Rwanda and being supported by A.I.D. and other donors. The PMPR's goal is to contribute to growth in employment and production in manufacturing and related sectors (e.g. commerce). The Program Assistance Approval Document (PAAD) contains additional performance indicators designed to evaluate the overall structural adjustment program. USAID/Rwanda has scheduled an evaluation for August 1993 to assess the contribution of the PMPR to the program goal. While these indicators may be useful to measuring the impact of the overall structural adjustment program, we do not believe the performance indicators can measure the impact of the PMPR separately from other donor programs as well as other external factors. However, we believe the performance indicator to measure the reduction in Government arrears meets the intent of A.I.D. policy and supplemental guidance.

REPORT ON INTERNAL CONTROLS

This 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 assess the applicable internal controls when necessary to answer the audit objectives. Those standards also require that we 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 A.I.D.'s internal control structure to determine our auditing procedures in order to answer the audit objectives and not to provide assurance on USAID/Rwanda's overall internal control structure.

For the purposes 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, determined whether they were placed in operation, and assessed control risk.

General Background on Internal Controls

Under the Federal Managers' Financial Integrity Act (the Integrity Act) and implementing policies issued by the Office of Management and Budget (OMB), A.I.D. is responsible for establishing and maintaining adequate internal controls. The General Accounting Office (GAO) has issued a document entitled "Standards For Internal Controls In The Federal Government" to be used by agencies in establishing and maintaining internal controls.

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 changes in conditions may require additional procedures or the effectiveness of the design and operation of policies and procedures may deteriorate.

In performing this audit, we found certain problems which we consider reportable under the Integrity Act and OMB's reporting requirements. Reportable conditions are those which in our judgement could adversely affect A.I.D.'s ability to ensure that resource use is consistent with laws, regulations and policies; that resources are safeguarded against waste, loss and misuse; and that reliable data is obtained, maintained, and disclosed in reports.

Conclusions for Audit Objective One

The first audit objective concerned controls to ensure that the accountability environment in the host country was assessed in accordance with A.I.D. policy and the supplemental guidance. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in the supplemental guidance contained in State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency", dated June 1991. For the purposes of this report, we have classified the relevant policies and procedures into the following categories: the general assessment process and the formal/informal assessment process.

We reviewed USAID/Rwanda's internal controls relating to the above processes. Our tests showed that internal controls relating to both processes were properly implemented. Therefore, we limited our testing to ensuring that assessments conducted by USAID/Rwanda met the requirements of Policy Determination No. 18 and State cable No. 204855.

Conclusions for Audit Objective Two

The second objective concerned the design of the grant agreement and amendments in accordance with A.I.D. policy and the supplemental guidance. In planning and performing our audit of the Production and Marketing Policy Reform (PMPR) Program, we considered the applicable internal control policies and procedures cited in Policy Determination No. 18 and State cable No. 204855 of June 1991. For the purposes of this report, we classified the relevant policies and procedures for ensuring the grant agreement includes provisions for generating, programming and managing local currency.

We reviewed USAID/Rwanda's internal controls relating to the above. Our assessment showed that control procedures relating to the design of the grant agreement and amendments were implemented, except that, USAID/Rwanda did not include provisions for audit of the special local currency account in PMPR's Program Assistance Approval Document (PAAD) and grant agreement. In addition, the grant agreement does not have provisions for ensuring that: (i) additional generations resulting from exchange rate fluctuations were deposited into the special account and made available to the PMPR Program, (ii) local currency generations from interest on the dollar account were deposited into the special account, (iii) local currency generations were deposited into interest-bearing accounts, and (iv) local currency generations were quickly disbursed from the special account. Except for the lack of provisions for audit which is covered under this audit objective, the other control weaknesses are discussed under Audit Objective Three.

We considered the lack of audit provision in the grant agreement a significant reportable weakness. Since this weakness was not included in USAID/Rwanda's 1991 internal control assessment under the Integrity Act, we recommended that it be included in the next assessment, if it is not corrected.

Conclusions for Audit Objective Three

The third audit objective concerned controls to ensure that local currency generations were deposited and quickly disbursed in accordance with A.I.D. policy and the supplemental guidance. In planning and performing our audit of this area, we considered the applicable internal control policies and procedures cited in Policy Determination No. 18 and the supplemental guidance contained in State cable No. 204855 of June 1991. For the purposes of this report, we have classified the policies and procedures into the following categories: the local currency generation, deposit and disbursement processes.

Our review of USAID/Rwanda's internal controls relating to the local currency generation, deposit and disbursement processes showed that internal controls were not properly implemented. Therefore, we could not rely on them in designing our audit approach. However, we conducted more extensive testing described in Appendix I, to answer this audit objective. For the purposes of this audit objective, we considered the following deficiencies significant reportable conditions:

> Controls were not implemented to ensure that: (1) additional local currency generations resulting from exchange rate fluctuations were deposited in the special account and were therefore available for joint programming; (2) the grant agreement provided for the deposit into the special account of local currency generated by the interest earned on the dollar account; (3) local currencies were deposited into interest bearing accounts; and (4) local currencies deposited in the special account were disbursed quickly.

The internal control weaknesses relating to the generation of local currency from interest bearing accounts and from interest on the dollar account were not included in USAID/Rwanda's 1991 internal control assessment. Therefore, we recommend that these weaknesses be included in the next assessment, if they remain uncorrected. For the purposes of the Integrity Act, we did not consider the other deficiencies material reportable conditions.

Conclusions for Audit Objective Four

The fourth audit objective concerned controls to ensure that local currencies were programmed and used for the intended purposes in accordance with A.I.D. policy and the supplemental guidance. In planning and performing our audit of this area, we considered the applicable internal control policies and procedures cited in Policy Determination No. 18 and the supplemental guidance contained in State cable No. 204855 of June 1991. For the purposes of this report, we have classified the relevant policies and procedures into the following categories: the process of programming local currency, the process of establishing criteria for local currency usage, and the process of monitoring local currency usage against the established criteria.

Our review of USAID/Rwanda's internal controls relating to the local currency programming process showed that internal controls relating to this process were properly implemented. Therefore, we limited our testing to ensuring that the programming option adopted by

USAID/Rwanda was acceptable under Policy Determination No. 18 and State cable No. 204855.

Our review of USAID/Rwanda's internal controls relating to the use of local currency showed that internal controls relating to this process were not properly implemented because provisions for audit were not included in the program agreement. This internal control weakness was reported under Objective Two.

Conclusions for Audit Objective Five

The fifth audit objective concerned controls to ensure that the impact of the local currency programs was evaluated in accordance with A.I.D. policy and the supplemental guidance. In planning and performing our audit of this area, we considered the applicable internal control policies and procedures cited in Policy Determination No. 18 and the supplemental guidance contained in State cable No. 204855. For the purposes of this report, we have classified the policies and procedures into the following category: the program evaluation process.

Our review of USAID/Rwanda's internal controls relating to the program evaluation process showed that internal controls were properly applied. Therefore, we limited our testing to ensuing that performance indicators developed by USAID/Rwanda were verifiable as required by Policy Determination No. 18 and State cable No. 204855.

REPORT ON COMPLIANCE

This section summarizes our conclusions on USAID/Rwanda's compliance with the Department of State cables sent to the missions each year which require each Mission to comply with the Federal Managers' Financial Integrity Act.

Scope of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards which 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 and illegal acts that could significantly affect the audit objectives). Those standards also require that we 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/Rwanda's compliance with the Federal Managers' Financial Integrity Act (FMFIA) of 1982.

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 a failure to follow requirements of laws or implementing regulations, 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 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 and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with the FMFIA Act is the overall responsibility of A.I.D. which, in turn, requires each mission to comply with the Act as set forth by binding policies in Department of State cables sent to missions each year. The FMFIA Act mandates that Agency internal controls provide reasonable assurance that funds, property, and other assets are safeguarded against waste, loss, unauthorized use and misappropriation.

Conclusions on Compliance

We reviewed USAID/Rwanda's compliance with the general assessment cable guidance for 1991 and found that USAID/Rwanda performed an internal control assessment for the year ending September 30, 1991 in compliance with binding cable guidance for the FMFIA despite the unreported weaknesses discussed in the report on internal controls.

MANAGEMENT COMMENTS AND OUR EVALUATION

USAID/Rwanda agreed with most of the report's findings and recommendations. The Mission's response on the draft report is included in its entirety in Appendix II of this report. The representation letter that USAID/Rwanda provided on this audit was fully acceptable. As a result, this report does not contain any qualifying language on the positive aspects of the Mission's performance. The Mission's response to each recommendation, actions proposed or taken, our comments on those actions, and any additional actions that are required to close the recommendations are discussed below.

•Recommendation No. 1.1 - to amend the program agreement for the Production and Marketing Policy Reform Program to include the provisions for audit (see page 7). USAID/Rwanda agreed to amend the program grant agreement to include the provisions for audit. Therefore, we consider Recommendation No. 1.1 resolved. Regarding USAID/Rwanda's comments on this recommendation, we believe the Mission's statement that current Africa Bureau practice governing non-project assistance does not permit mixing technical assistance (including audits) in with non-project cash grants, if correct, conflicts with A.I.D. policy contained in Policy Determination No. 18 (PD-18) and State cable No. 204855 which require audits be conducted when local currency is generated under commodity import, cash transfer, and non-project sector assistance programs. Also, we disagree with USAID/Rwanda's statement that provisions for audit had been adequately addressed in the design documents for other related projects. It is the auditors' opinion that the provisions for audit were not adequately addressed in the design documents for other related projects and the Production and Marketing Policy Reform (PMPR) program grant agreement. We will close the recommendation on receipt of documentation showing that the program agreement has been amended to include the provisions for audit.

•Recommendation No. 1.2 - to report in the next Federal Managers' Financial Integrity Act reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with USAID/Rwanda's provisions for audit in the program grant agreement, if this weakness is not corrected (see page 7). Based on the Mission's agreement to amend the program grant agreement as required by Recommendation No. 1.1 above, we consider Recommendation No. 1.2 resolved. We will close this recommendation on receipt of documentation showing the program agreement has been amended or evidence that the weakness has been reported under the Federal Managers' Financial Integrity Act (FMFIA).

•Recommendation No. 2 - to amend the program grant agreement to ensure that additional local currency generations, estimated to be $870,000, are accounted for and deposited to the special account and make available for joint programming under the second tranche of $10 million (see page 10). Recommendation No. 2 is unresolved. USAID/Rwanda did not accept the recommendation and makes arguments for their interpretation of PD-18. The Mission's interpretation is based on considerations other than maximum deposits. However, the audit finding is based on accountability. Since USAID/Rwanda designed the PMPR Program to track U.S. dollars provided to the Government of Rwanda, we see a direct link between the sale of dollars to Rwandan importers and the generation of local currency from these sales. The fact that the Government agreed to provide an "advance" of the equivalent amount of local currency for the dollars transferred to the Government does not relieve the Mission of its responsibility for ensuring all local currency generated should be controlled and programmed, in conjunction with the host country, to maximize the Program's development impact, which the Mission states is A.I.D.'s primary intent for local currency generations. Furthermore, local currencies that are generated by U.S. development assistance but are not accounted for and controlled by USAID/Rwanda could result, due to the continuing civil war, in a violation of Congressional legislation governing appropriated funds which prohibits the use of local currency for law enforcement activities and military or paramilitary purposes. Therefore, we believe the design of the program grant agreement should have considered the potential for additional local currencies being generated by the sale of dollars at a higher rate than the rate used to make the advance. In addition, we do not believe it is necessary to direct this recommendation to A.I.D./Washington since it is an accountability issue and not a question of our interpretation of A.I.D. guidance. Recommendation No. 2 will be resolved upon the Mission's agreement to amend the program grant agreement and will be closed on receipt of documentation showing the program grant agreement has been amended to ensure that additional local currency generations are accounted for and deposited to the special account and made available for joint programming under the second tranche of $10 million.

- Recommendation No. 3.1 - to amend the program agreement for the Production and Marketing Policy Reform Program to provide for the deposit of $193,117 in local currency generated by the interest earned on the dollar account (as well as future earnings estimated at $128,745) into the local currency special account (see page 12). USAID/Rwanda agreed with the dollar amount reported in this recommendation. We consider Recommendation No. 3.1 resolved. We will close the recommendation on receipt of evidence from USAID/Rwanda that the PMPR program agreement has been amended to provide for the deposit of local currency generated by the interest earned on the dollar account into the local currency special account.

- Recommendation No. 3.2 - to report in the next Federal Managers' Financial Integrity Act reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with grant agreement provisions for the generations of local currency from interest on the dollar amount if this weakness is not corrected (see page 12). Based on the Mission's agreement to amend the program grant agreement as required by Recommendation No. 3.1 above, we consider Recommendation No. 3.2 resolved. We will close the recommendation on receipt of documentation showing the program agreement has been amended or evidence that the weakness has been reported under FMFIA.

- Recommendation No. 4.1 - to amend the Production and Marketing Policy Reform Program grant agreement by requiring the Government of Rwanda to deposit local currency generations into interest bearing accounts or make a written determination not to follow A.I.D.'s preference for interest bearing account (see page 14). Based on the Mission's agreement to amend the program grant agreement, we consider Recommendation No. 4.1 resolved. We will close the recommendation on receipt of documentation showing the program agreement has been amended to require the Government to deposit local currency generations into interest bearing accounts.

•Recommendation No. 4.2 - to report in the next Federal Managers' Financial Integrity Act reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with USAID/Rwanda's deposit of local currency in non-interest bearing accounts, if this weakness is not corrected (see page 14). Based on the Mission's agreement to amend the program grant agreement as required by Recommendation No. 4.1 above, we consider Recommendation No. 4.2 resolved. We will close the recommendation on receipt of documentation from USAID/Rwanda that the program agreement has been amended and evidence showing that local currencies have been deposited into an interest bearing account or evidence that the weakness has been reported under FMFIA.

•Recommendation No. 5 - to amend the eligibility criteria for the disbursement of the local currency equivalent of $14 million remaining in the special account (see page 16). We revised our recommendation to more clearly focus on the need to change the PMPR Program's eligibility criteria for disbursing the local currency. Based on the Mission's agreement to amend the eligibility criteria using Program Implementation Letter (PIL) No. 7 as the vehicle, we consider Recommendation No. 5 resolved. We will close the recommendation on receipt of documentation showing that PIL No. 7 has been approved and is in effect.

•Recommendation No. 6 - to schedule an audit of all the disbursements of funds from the special account to ensure that the payments made met the eligibility criteria (see page 19). We consider Recommendation No. 6 unresolved. While USAID/Rwanda had clearly shown its intent to conduct an audit, the Mission had not actually scheduled or arranged for an audit of the special account. The listing of audits the Mission planned to conduct and cabled to Regional Inspector General for Audit, Nairobi on August 16, 1991 validated its intention but a draft Project Implementation Order/Technical Services (PIO/T) was not provided by Mission staff until after the auditors discussed the problem with staff in September 1992. USAID/Rwanda took exception to the statement in the draft report that the Mission did not have reasonable assurance that the local currency equivalent of $1.05 million (Rwf 125 million) disbursed from the special account as of September 17, 1992 was used for intended purposes. It is our opinion that the Mission will not have reasonable assurance that the local currencies were used for intended purposes until an audit is conducted and the findings support the Mission's position. Also, we believe that the continuing civil war in Rwanda increases the risk that local currencies could be used for activities prohibited by Congressional legislation including law enforcement activities and military or paramilitary purposes. Our review of a sample of payment vouchers disclosed several payments whose eligibility was questionable. Finally, the Mission's main reason for not accepting Recommendation No. 6 is the use of the word "all" disbursements should be audited. Audit of "all" disbursements does not mean that sampling techniques would not be used; it simply means that all disbursements will be included in the audit universe and would be eligible for selection. We will consider Recommendation No. 6 resolved when the Mission agrees with the recommendation as stated in the report. We will close the recommendation on receipt of documentation showing that USAID/Rwanda has scheduled an audit of the special local currency account.

SCOPE AND METHODOLOGY

Scope

We audited USAID/Rwanda's Management of Host Country-Owned Local Currency in accordance with generally accepted government auditing standards. We conducted the audit from September 21, 1992 to November 20, 1992 in the offices of USAID/Rwanda and covered the Production and Marketing Policy Reform (PMPR) Program. The PMPR was the only non-project assistance agreement signed after Policy Determination No. 18 and State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency," which became effective on July 1, 1991 and June 21, 1991, respectively.

In performing our audit, we obtained documentary and testimonial evidence from the offices of USAID/Rwanda, the Government of Rwanda Ministry of Finance, the Banque de Kigali, the Banque Commerciale du Rwanda, and the Banque Continentale Africaine (Rwanda). This is discussed in detail under the methodology for each audit objective. The audit covered the systems and procedures relating to (1) assessing the accountability environment in the host country, (2) designing of the grant agreement and amendments, (3) depositing and quick disbursing local currency generations, (4) programming and use local currencies for intended purposes, and (5) evaluating of the impact of the local currency program.

According to USAID/Rwanda records, a total of $25 million was obligated for the PMPR Program, and $15 million disbursed as of October 28, 1992. The audit covered the entire local currency equivalent of $15 million (Rwf 1.8 billion) that was deposited into the special account on December 31, 1991 and the entire equivalent of $1.05 million (Rwf 125 million) withdrawn at the time of the audit.

As part of this audit, we reviewed USAID/Rwanda's internal control assessment in light of the internal control weaknesses identified in the Report on Internal Controls (see page 22) and found they had not been reported. We also reviewed seven prior RIG/A/N audit reports relating to host country-owned local currency --Audit Report Nos. 3-696-89-01 (Rwanda's Policy Reform Initiatives in Manufacturing and Employment), 3-613-90-06 (Zimbabwe Local Currency Generations), 3-612-92-14 (Malawi Enterprise Development). 3-615-92-03 (Kenya Commodity Import Programs); 3-687-92-01 (Madagascar Sector Assistance Programs), 3-696-91-03-N (Rwanda Policy Reform Initiatives in Manufacturing and Employment), and 3-696-92-08 (Rwanda Management of Cash Advances and Expenditures). There were no prior audit findings to review because the Rwanda PMPR Program had not been previously audited.

We did not test the reliability of computer-generated data used in the report because: (1) the reliability of the data was not crucial to accomplishing the audit objectives, and (2) computer-generated data has been used only to a limited extent, e.g. for background and informational purposes. We have cited the source of the information wherever computer-generated data is used in the report.

Methodology

The methodology for each audit objective follows.

Audit Objective One

To accomplish this objective, we obtained and reviewed the Mission's assessment of the host government's accountability environment to determine whether the assessment was in accordance with Policy Determination No. 18 (PD-18) and State cable No. 204855. We discussed the assessment with the USAID/Rwanda program officer and controller. Also, we reviewed the Program Assistance Approval Document (PAAD) to determine whether the Mission documented a conclusion on the capability of the Ministry of Finance to effectively manage the special account. Further, we reviewed the PAAD to determine whether USAID/Rwanda had documented the basis for its decision to rely on an informal assessment, i.e. its favorable experience with the Ministry of Finance in the management of another special local currency account.

Audit Objective Two

To accomplish this objective, we determined whether all provisions on generating, programming and managing host country-owned local currency required by PD-18 and State cable No. 204855 were included in the PMPR program agreement.

Audit Objective Three

To accomplish this audit objective, we assessed whether local currency generations were deposited and quickly disbursed in accordance with PD-18 and State cable No. 204855. Specifically, we verified whether the whole of the first tranche of $15 million out of $25 million obligated, was transferred to the Citibank account on December 24, 1992 as required by the grant agreement. Further we determined whether a special local currency account was established as required by PD-18 and the Supplemental Guidance, and whether local currency equivalent to $15 million was deposited into this account. Also, we determined whether additional generations due to exchange rate fluctuations were deposited into the special account, whether local currency generations were deposited in interest bearing accounts, and whether generations from interest on the dollar account were deposited into the special account.

To determine whether local currency generations were quickly disbursed as required, we quantified the amount of withdrawals from the special account as of September 17, 1992. We then compared the local currency withdrawn from the special account up to that point, Rwf 125 million, with the total amount that was available on December 31, 1991, Rwf 1.8 billion. The total amount should have been fully disbursed as of June 30, 1992 according to the grant agreement.

In addition, we interviewed the PMPR program officer and the Mission controller.

Audit Objective Four

To accomplish this objective, we assessed whether local currency generations were programmed and used for intended purposes in accordance with PD-18 and State cable No. 204855. We determined whether the programming method used by USAID/Rwanda was one of the four programming options given by PD-18, and discussed with USAID/Rwanda officials methods used to ensure that local currencies were used for intended purposes. Also, we reviewed Ministry of Finance documentation showing what goods and services the local currencies paid for, and determined whether USAID/Rwanda used audits to ensure that local currencies were used for authorized purposes. We reviewed $751,071 (Rwf 99,441,814) out of the local currency equivalent of $1.05 million (Rwf 125 million) disbursed as of September 17, 1992 to determine what goods and services were paid for. This sample consisted of 51 out of a total of 213 payments to domestic creditors. The sample was judgmentally selected to include 15 large payments (over Rwf 1 million), 15 unusual payments (for instance, payments to hotels and restaurants) and 21 small payments (not exceeding Rwf 5000).

Audit Objective Five

To accomplish this objective we assessed whether the impact of the PMPR program will be evaluated in accordance with PD-18 and State cable No. 204855. We determined whether the grant agreement and the Program Assistance Approval Document (PAAD) identified verifiable performance indicators and discussed how these indicators would be measured. Also, we determined whether USAID/Rwanda had made provision for the evaluation of the PMPR program. In addition we interviewed the PMPR program officer and the Mission controller.

U.S. GOVERNMENT
memorandum

DATE: February 18, 1993

REPLY TO ATTN OF: Gary L. Nelson, Director, USAID/Rwanda Gary Nelson

SUBJECT: USAID/Rwanda Comments on the *Audit of USAID/Rwanda Management of Host-Country-Owned Local Currency*, Task No. 33101392, Report No. 3-696-93-xx

TO: Everette B. Orr, Regional Inspector General, Audit

Summary

This memo presents the Mission's comments on the subject draft report. It has been sent to RIG/A/N by courier to aid in placing a high-quality copy of the memo in the final audit report as an attachment.

In Section I., Recommendations 1.2, 3.1, 3.2, 4.1, and 4.2 are resolved. Recommendation 1.1 is resolved with comment. Recommendations 5 and 6 could be resolved before the issuance of the report, if RIG/A/N modifies the recommendations as follows:

> ***Revised Recommendation No. 5:*** **"USAID/Rwanda amend the eligibility criteria for the disbursement of the local currency equivalent of $14 million remaining in the special account."**
>
> ***Revised Recommendation No. 6:*** **"USAID/Rwanda schedule an audit, using generally accepted auditing practices, of the disbursements of funds from the special account to ensure that the payments made met the eligibility criteria."**

Recommendation 2 remains unresolved. USAID/Rwanda cannot agree with RIG/A/N that the USAID/Rwanda process for the deposit of local currency generations is inappropriate. Policy Determination Number 18 (PD-18) and the supplementary local currency guidance lack clarity and definition in this matter and USAID/Rwanda considers that these guidance documents, plus A.I.D.'s own financial control practices, encourage up-front deposit of local currency (except in cases of hyperinflation). USAID/Rwanda therefore requests that this recommendation be transferred directly to AID/W in the final IG report on local currency programming, and that the recommendation be reformulated as follows to focus on the issue of when local currency may be generated. USAID/Rwanda proposes:

> ***Revised Recommendation No. 2:*** **"AID/W clarify PD-18 and the Supplementary Local Currency Guidance cable to accurately reflect intentions of AID/W regarding local currency deposits."**

In Section II., the most significant comment is the lack of mention in the draft Audit Report on the ***Representation Letter*** signed by the Mission Director and given to the Director of RIG/A/N during his November trip to Rwanda. Given the importance of representation letters, RIG/A/N is requested to comment immediately on the Representation Letter provided in November 1992.

Finally, USAID/Rwanda appreciates RIG/A/N's role in identifying and raising important design and implementation issues applicable both to the USAID local currency program in Rwanda and to A.I.D.-funded non-project assistance programs in general.

SECTION I. COMMENTS ON RECOMMENDATIONS

Recommendation 1.1 *"Amend the program agreement for the PMPR Program to include the provisions for audit."*

Recommendation 1.1 is resolved, but with comment. Specifically, the Audit Report states, "USAID/Rwanda did not include audit provisions... because USAID/Rwanda officials believed the provisions for audit has been adequately addressed in the design documents for other related projects even though they had not been."

The first part of the statement is correct. USAID/Rwanda notes that it used the currently approved wording and format for program grant agreements as contained in A.I.D. Handbook No. 4 on non-project assistance. The format program agreement in Handbook No. 4 allows for A.I.D. to conduct audits and other reviews. However, it is not as explicit as the new guidance. USAID/Rwanda still recommends that A.I.D. formally amend A.I.D. Handbook Number 4 to reflect A.I.D.-wide policy. This change would help avoid cases where a Mission follows the A.I.D. official handbooks to the letter, but is still found wanting.

The later part of the statement, *"... even though they had not been."* is not correct. Current Africa Bureau practice governing non-project assistance does not permit mixing technical assistance (including audits) in with non-project cash grants. A separate project assistance mechanism is required. USAID/Rwanda did make provision for the audit of the PMPR program in the first amendment to the PRIME project when $493,000 was added. The PMPR program grant agreement (Annex I, Section II.(4)) details that these monies will be used to finance technical assistance to support the implementation, monitoring, and evaluation of the Production and Marketing Policy Reform Program. This type of funding arrangement is authorized by Supplemental Local Currency Guidance, Section 5.1.0.2. Furthermore, the audit of PMPR was included in USAID/Rwanda's 1992 audit plan sent to RIG/A/N on August 16, 1991 -- a full month before the PMPR program was signed! Indeed, the draft PIO/T for the audit the program, given to RIG/A/N staff in November 1992, is funded from PRIME's $493,000.

In addition, USAID/Rwanda has made clear to Government of Rwanda officials in the Ministries of Plan, of Finance, of Foreign Affairs and Cooperation that the PMPR program would be audited. No one in the Government of Rwanda, from Ministers on down, has raised any objection or difficulty with USAID/Rwanda's comments. Meetings where audits were discussed included one in which RIG/A/N staff met with the Ministry of Finance's Director of Cabinet, who is the number two person in the Ministry. To date, the *Government of Rwanda has not denied any document or request for information to USAID/Rwanda staff or to the staff of RIG/A/N.* The documents requested and reviewed by USAID/Rwanda and RIG/A/N staff are the same documents one would use for an audit. USAID/Rwanda concludes that the absence of the additional detail in the PMPR program grant agreement has not hindered the implementation of the program or A.I.D.'s right to audit the program. USAID/Rwanda therefore cannot agree with the RIG/A/N statement, *"... even though they had not been."* If this is deleted, the USAID/Rwanda agrees with this recommendation.

Recommendation 1.2 *"Report in the next Federal Manager's Financial Integrity Act Reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with USAID/Rwanda's provision for audit in the program grant agreement, if this weakness is not corrected."*

Recommendation 1.2 simply requires the Mission to report to AID/W if the program agreement has not been amended by the next reporting cycle. <u>This Recommendation is resolved.</u>

Recommendation 2 *"We recommend that USAID/Rwanda amend the program grant agreement to ensure that additional local currency generations, estimated to be $870,000, are accounted for and deposited to the special account and made available for joint programming under the second tranche of $10 million."*

Recommendation 2 is unresolved. The Mission's position on this recommendation, as previously stated in the USAID/Director to RIG/A/N/Director Memo, dated December 4, 1992, remains the same: the Mission can not accept the recommendation. Subsequently, the Mission asked for the advice of the Regional Legal Advisor (RLA), who concurs in the Mission's interpretation of A.I.D. policy and guidance.

In the discussions between USAID/Rwanda and RIG/A/N, RIG/A/N noted that it would follow-up with AID/W on what the guidance intended. This issue may have to remain unresolved until AID/W decides and the missions receive guidance from their regional bureaus. We request that this recommendation be transferred directly to AID/W in the final report.

The recommendation should clearly indicate that the issue is the timing of local currency deposits. The questions are:

- What do PD-18 and the supplementary guidance require?
- What are the programmatic priorities and risks?

RIG/A/N argues that additional local currencies could have been available for program purposes if the grant had required the deposit of local currency as it was generated rather than an immediate deposit at the time the dollars were provided to the Government of Rwanda. USAID/Rwanda still believes strongly that the up-front deposit of local currency remains justifiable, given

- the guidance in PD-18 and the Supplementary Guidance,
- the assessments of the World Bank and IMF on the exchange rate (with which USAID/Rwanda agrees),
- the historical trends of the relationship between the dollar and the Rwandan Franc,
- the programmatic interests for de-linking the program's dollar and local currency components, as well as
- the events after PMPR implementation began.

CONFORMITY WITH GUIDANCE

PD-18 treats the question of timing only in a general sense:

> "4.2 *If generated, the local currency must be deposited into a separate account for joint programming. A.I.D. and the host government may specify in the agreement when during the life of the agreement local currency deposits shall be made and the amounts of local currency to be deposited. Such agreed upon amounts must accurately reflect projected local currency generations under the agreement (STATE 204855, para 3.0).*" (page 4), and

> "4.4 *Mission can always require that the recipient government set aside an agreed upon amount of local currency as a condition of assistance -- regardless of the actual use of the dollars.*" (page 5).

The Supplementary Guidance cable states,

> "3.0 *The amount of local currency to be deposited into the Special Account will be determined by the Agreement between the host country and A.I.D. The Agreement may not preclude local currency deposits if the Agreement will generate them but shall require them based upon a reasonable estimate of the anticipated amount to be generated.*

Neither PD-18 nor the Supplementary Guidance states a clear preference for any particular option. PD-18 clearly permits (Section 4.4) the up-front deposit of funds and the Supplementary Guidance clearly suggests that the amount of local currency deposits should be defined prior to signing the agreement. USAID/Rwanda believes that the approach of using up-front deposits is fully consistent with A.I.D. guidance.

TIME OF DEPOSIT AND EXCHANGE RATE RISK

PD-18 is silent on the subject of changes in exchange rate. However, the Supplemental Guidance indicates that exchange rate changes should be considered:

> "3.1. ... *This authority is intended to be used to reasonably fix in advance the amount of local currency to be generated during the course of the A.I.D. agreement. Major fluctuations in the host government exchange rate or the public/private sector mix of the*

assistance must be accounted for through appropriate agreement provisions to allow revisions to the agreed upon local currency amount."

USAID/Rwanda interprets this guidance to mean that unless *"MAJOR"* devaluations can be reasonably foreseen, the amount of local currency to be deposited should be fixed in the agreement. USAID/Rwanda further interprets the intent of *"major"* in this guidance to be to deal with the hyper-inflation situations that prevail in many countries, but not in Rwanda.

PD-18 also counsels A.I.D. missions that a program's overall goal is more important than the local currency component. It states,

> *"... that A.I.D. participation in programming FAA-generated local currency is not an end in itself but rather a tool for moving toward the more important goal of an overall host country budget that represents a sound development-oriented allocation ... of budgetary resources..."* (page 3).

A.I.D.'s primary intent for local currency generations is not to maximize the amount that could be obtained from recipient governments, but to maximize the program's developmental impact. In the case of PMPR, the overall goal, *"contribute to growth in employment and production in the medium term,"* was best served by reassuring the commercial sector by blocking local currency for payment of arrears as early as possible.

THE USAID PROCESS

USAID/Rwanda chose the option of an assured, up front deposit of local currency. The program agreement contains the following procedure for generating the local currency which conforms to PD-18 and the Supplementary Guidance, and which was in fact followed:

- GOR complies with the policy conditionality associated with the first tranche,

- USAID transfers the first tranche of $15 million into a Special Dollar Account for this program at Citibank New York in December 1992 (A.I.D. recorded the dollars as disbursed in December 1992),

- GOR immediately deposits <u>all</u> the local currency equivalent in a Special Local Currency Account for this program at the central bank of Rwanda using the highest legally permissible exchange rate on the date the dollar transfer is made, which was Rwf 118.7 per $1.00, and

- the draw down of dollars deposited in Citibank account begins as importers place their requests for foreign exchange to finance imports.

Between when the dollars were transferred and February 1993, over $13 million of the $15 million first tranche funds were disbursed, with importers paying Rwf 120.8 to Rwf 141.1 per $1.00 for the dollars.

THE ARGUMENTS

RIG/A/N argues that more local currency could have been generated if USAID required that the local currency be generated when the dollars are sold from the Citibank account rather than the moment when USAID places the dollars in the Citibank account. RIG/A/N makes the statement that USAID *"... should have considered the consequences of ... [exchange rate] fluctuations when estimating the amount of local currency to be generated."* (page 18).

USAID/Rwanda disagrees with RIG/A/N's assessment. How to generate local currency is a programmatic decision. At the time of the program design, the decision was whether to maximize surety ("certitude") and availability or maximize potential deposits. Every mission must weigh the risk of currency devaluation to which the local currency account may be exposed, if the local currency deposits are paid in full immediately after the dollar deposit is made, against two other factors. They are: (i) the advantages of the early availability of the local currency for program purposes, and (ii) the certitude in knowing that the deposits will be made.

The first factor is often critical. The USAID/Uganda program is just one current example where several of its projects are "local currency cash starved" because the non-project assistance program dollars are not being used by importers as rapidly as expected. Had it been able to de-link the dollars and local currency, its projects would now be able to operate. Fortunately in the case of Rwanda, the GOR had both the commitment and the local currency to pay up front. Not all USAIDs are that fortunate.

The second factor, certitude, is also a strong consideration as it is not always clear that there will be the demand for the dollars, or that the government will deposit the local currency, once generated, in the Special Local Currency Account. Sudan is a case where the local currency was generated as the dollars (and U.S. food aid) were sold, but they were not deposited in the Special Local Currency Account.

USAID/Rwanda's interpretation of PD-18 is that certitude and availability are preferred over maximum deposits unless major changes in the exchange rate are expected. This conservative bias conforms to fundamental aspects of government fund control accounting. Governments, including both the U.S. and Rwandan Governments, prefer exchange rate stability in their multi-currency dealings, because effective government accounting is conservative, budget-controlled, and seeks to avoid unanticipated changes, even if they can be potentially positive. Indeed, this is why, for example, U.S. Treasury Disbursing Offices, such as RAMC/Paris, are not allowed to engage in currency transactions beyond actual disbursement needs, despite their intimate and potentially lucrative knowledge of the currency markets.

Moreover, this conservative bias is reflected in A.I.D.'s own policy towards accounting for local currency transactions, in particular debts it collects in local currency. The exchange rate of an advance, for example, is fixed when the advance disbursement is made. Subsequent liquidations are always converted at the original exchange rate when the advance was made, regardless of the actual exchange rate when the expenditure is made or the liquidation processed. The same is true for bills for collection in local currency. No matter what the exchange rate is when the bill is actually paid, the liquidation is made at the original exchange rate when the bill was issued. This of course means that local currency debts to A.I.D. may be paid with a depreciated or appreciated currency. Simply put, A.I.D.'s own local currency accounting system prefers to discount the exchange rate in favor of certitude. The underlying message is that A.I.D.'s own internal financial management policies favor certitude over maximization.

Under the option USAID chose, the *definite* benefits are that:

- the exchange rate risk is eliminated and the program knows how much local currency will be generated.

- the local currency component of the program is de-linked from the dollar component, thus allowing for different rates of implementation between program components. It was preferable to consider the provision of local currency for debt relief as a separate transaction from the eventual sale of dollars to the private sector. Linking the timing of the GOR's need to retire debt to the timing of the private sector's demand for foreign exchange is spurious and risked mitigating the effectiveness of the debt-relief portion of PMPR program.

Given that the local currency was to be used to pay off GOR arrears to the private sector, if the local currency could be disbursed before the dollars, private businesses could then use that local currency to buy the dollars. Similarly, when private businesses know that the GOR has already paid local currency up-front into a blocked account reserved for reducing government arrears to private suppliers, it bolsters their confidence in the government's intentions. The GOR also agreed that this option was useful in helping business confidence and in helping "jump-start" the new foreign exchange allocation system --- which was being supported by the PMPR program.

The *potential* risk is that the maximum amount of local currency may not be generated.

Notwithstanding the U.S. Government bias for certitude and programmatic considerations, USAID/Rwanda did consider the possibility of exchange rate fluctuations. The data on exchange rate risks prevailing during the design when the decision on how to generate local currency had to be made follows:

A. When PMPR was designed, the World Bank and the IMF did not have any issue with Rwanda's exchange rate. Additional devaluations were not a central topic of discussion. The GOR had devalued it currency by 40 percent in late 1991, as the Audit Report clearly states. However, with that change, the exchange rate ceased to be a key issue. The key issues focused upon by the donors were those upon which the PMPR program focuses. (The PMPR program was designed starting in April 1992.)

B. From the historical perspective, USAID/Rwanda could not have concluded that the RIG/A/N option was "better." IMF's *International Financial Statistics* (a.k.a. "the blue book") data show that over the past twenty-odd years, the dollar has, on an annual basis, regularly lost against as well as gained against the Rwandan Franc. Between 1970 and 1991 on an annual basis, the dollar lost ground against the Franc six times, gained against the Franc seven times, and remained without change eight times. Thus, historically, for one-third of the time, local currency would have been lost when using the RIG/A/N option. Similarly, in only one-third of the time would local currency have been lost when using the USAID/Rwanda option. For the first four months in 1992, the IMF blue book shows the dollar gaining twice and loosing twice. However, in value terms, the dollar tended to be weaker than the Franc between 1970 and 1991. When using 1970 as the base year, it was only in 1983-84 and again in late 1991 that the dollar was as strong as the dollar-to-Franc exchange rate in 1970. The reason is that the Franc has been pegged to a basket of foreign currencies. Over time, that basket of currencies has become stronger than the dollar, hence the Rwandan Franc become stronger against the dollar. Thus, the dollar-Franc relationship is related to movements on international currency markets. It is not a simple matter to predict the future dollar-Rwandan Franc exchange rates under such circumstances, particularly as dollar trading becomes increasingly volatile. Indeed, the dollar-franc relationship changes continually.

C. The immediate and final conversion of the dollars into local currency for debt relief was also appropriate as the target debt already existed and was denominated in local currency (Rwandan Francs). Thus, after the conversion and deposit into the Special Local Currency Account, the transaction was no longer subject to exchange rate risk. That is, the debt and the amount to pay off the debt were appropriately matched in the same currency, so that the amount of Rwandan Franc debt to be retired, which was what mattered to the GOR and USAID/Rwanda, was fixed.

The option USAID/Rwanda chose was detailed in the program documents reviewed in AID/W as part of the Africa Bureau's review process. The Africa Bureau agreed with USAID/Rwanda's assessments and approved the program.

As the Audit Report notes, the GOR devalued the Rwandan Franc by 15 percent in foreign currency terms in June 1992 -- during the implementation of the PMPR program. This could not have been predicted with any accuracy. The GOR did so unilaterally, not because of pressure from the World Bank or IMF. The devaluation was a GOR response to donor concerns about seeing some action on the growing budget deficit. The response desired by donors was a cut-back in certain spending programs and new taxes, not a small devaluation that did not address the core problem.

RIG/A/N asserts that a 15 percent devaluation should be considered *"major"* under PD-18 guidelines. USAID/Rwanda disagrees strongly. The Mission and the RLA interpretation of PD-18 is that "major" is to address cases of hyper-inflation. There is little comparison between Rwanda, with an inflation rate of 14.2 percent in 1991 and 8 percent in 1992, to other countries in which A.I.D.

operates, like those in Latin America or in unstable countries like Zaire, which have inflation rates exceeding 2,000 percent per year.

The Audit Report makes much of the notion that the Mission should not have permitted the GOR to pay its local currency obligation up-front without obtaining a commitment of additional local currency equivalent to the increments paid by importers above what they would have paid if the exchange rate had remained the same. The Mission's RLA notes that this argument is interesting but technically incorrect because the GOR extinguished its obligations when it paid the local currency in full in December 1991. The GOR has paid its "debt," so to speak. The GOR's purchase of the dollars can be compared to the purchase of any other dollar-denominated asset, such as a building in Manhattan. Having paid at once the full equivalent in local currency at the current exchange rate, there is no question of subsequent payments being made because of subsequent exchange rate fluctuations. What RIG/A/N is suggesting is that the GOR should nevertheless continue to be exposed to a foreign exchange risk on an obligation that has already been satisfied. This is, as the RLA notes, patently unfair and not required by PD-18.

CONCLUSION

USAID/Rwanda cannot accept this recommendation. The Mission finds that the deposit system defined for this program is fully consistent with the guidance and is appropriate in the Rwanda case. In the discussions between USAID/Rwanda and RIG/A/N, RIG/A/N noted that it would follow-up with AID/W to determine what the guidance intended. This issue may have to remain unresolved until AID/W decides and the missions receive guidance from their regional bureaus. USAID/Rwanda therefore requests that this Recommendation be transferred directly to AID/W in the final IG report on local currency programming, and that the Recommendation be reformulated as follows to focus on the issue of the timing of local currency deposits. USAID/Rwanda proposes:

> ***Revised Recommendation No. 2:*** **"AID/W clarify PD-18 and the Supplementary Local Currency Guidance cable to accurately reflect the intentions of AID/W regarding local currency deposits."**

Recommendation 3.1 *"Amend the program agreement for the Production and Marketing Policy Reform Program to provide for the deposit of $193,117 in local currency generated by the interest earned on the dollar account into (as well as future earnings estimated at $128,745) into the local currency special account."*

Recommendation 3.1 is resolved. The Mission accepts the figure cited in the text.

Recommendation 3.2 *"Report in the next Federal Manager's Financial Integrity Act Reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with grant agreement provisions for the generation of local currency from the interest on the dollar amount if this weakness is not corrected."*

Recommendation 3.2 simply requires the Mission to report to AID/W if the program agreement has not been amended by the next reporting cycle. This recommendation is resolved.

Recommendation 4.1 *"Amend the PMPR grant agreement by requiring the Government of Rwanda to deposit local currency generations into interest bearing accounts or make a written determination not to follow A.I.D.'s preference for interest bearing account."*

Recommendation 4.1 is resolved.

Recommendation 4.2 *"Report in the next Federal Manager's Financial Integrity Act Reporting cycle to the Assistant Administrator, Bureau for Africa, the internal control weakness associated with USAID/Rwanda's deposit of local currency or non-interest bearing account, if this weakness is not corrected."*

Recommendation 4.2 simply requires the Mission to report to AID/W if the program agreement has not been amended by the next reporting cycle. This recommendation is resolved.

Recommendation 5 *"We recommend that USAID/Rwanda establish procedures for the disbursement of the local currency equivalent of $14 million remaining in the special account."*

Recommendation 5 is not resolved, but could be resolved with a clarification in the recommendation language by RIG/A/N as follows:

> ***Revised Recommendation No. 5:*** **"USAID/Rwanda amend the eligibility criteria for the disbursement of the local currency equivalent of $14 million remaining in the special account."**

The issue is whether the PMPR program's eligibility criteria for disbursing the local currency should be changed. As summarized in USAID/Director to RIG/A/N/Director Memo, dated December 4, 1992, the PMPR program has procedures for utilizing the local currency. USAID/Rwanda also has had reviews with the GOR on the eligible uses of PMPR-generated local currency as well as competed a survey of recipients of PMPR-generated local currency. This should be reflected in the Audit Report text. USAID/Rwanda cannot agree to establishing procedures, as Recommendation No. 5 currently states, when procedures are already in place.

Also, the Audit Report text should reflect the RIG/A/N discussions with the GOR, as reported by RIG/A/N to USAID/Rwanda, during which GOR representatives reportedly indicated that they were on a "learning curve" regarding USAID regulations, and that they felt they could now disburse the funds with changes to the eligibility criteria. Indeed, USAID/Rwanda consultations and implementation reviews with GOR lead to the drafting of Program Implementation Letter Number 7 (PIL #7) referred to in the Audit Report.

USAID/Rwanda fully agrees with the Audit Reports statement, that the Recommendation will be closed "if PIL No. 7 is in effect" (page 31). However, the Recommendation must be more clearly focused on the issue: eligibility criteria. Thus, if the recommendation is revised as stated above, then USAID/Rwanda accepts Recommendation No. 5 as resolved.

Recommendation 6 *"We recommend that USAID/Rwanda schedule an audit of all the disbursements of funds from the special account to ensure that the payments made met the eligibility criteria."*

Recommendation 6 is not resolved, but could be resolved with a clarification in the recommendation language by RIG/A/N as follows:

> ***Revised Recommendation No. 6:*** **"USAID/Rwanda schedule an audit of the disbursements of funds from the special account to ensure that the payments made met the eligibility criteria, using generally accepted auditing practices and accounting principles as prescribed in A.I.D.'s supplementary local currency guidance."**

Corrections also need to be made in the text associated with the recommendation.

Specifically, the recommendation states that *"all"* disbursements must be audited. USAID/Rwanda believes that this goes well beyond the Supplementary Local Currency Guidance, which states,

> *"5.1.C.1. Audit Standards. Since local currencies are host-country owned, the audits of these local currencies do not necessarily have to adhere to U.S. GAO auditing standards. However, the audits should be professionally executed according to generally accepted auditing standards and accounting principles that have been prescribed by the host country law, or that have been adopted by public accountants in the host country together with generally accepted international auditing standards."*

Following accepted procedures, an audit company will undertake a sample of disbursements. Depending on the results of this sample review, the audit company will decide whether or not it is necessary to audit every (*"all"*) disbursement(s). The decision should be based on data collected by the auditors. As currently formulated, the recommendation carries a presumption of guilt. At the time of the RIG/A/N visits, USAID/Rwanda had not begun its own formal financial review of the local currency component. From this review, during which the Mission will work with Ministry of Finance staff, initial errors of interpretation will be corrected.

As discussed further below, the Mission already has completed a formal review of the dollar component of PMPR with the Ministry of Finance staff at the central bank. The central bank made the requested corrections and made all the reimbursements requested to the special dollar account. Thus, USAID/Rwanda requests the Recommendation be revised. <u>If revised as stated above, then USAID/Rwanda accepts Recommendation No. 6 as resolved.</u>

The text associated with this recommendation is misleading by its omission of available facts. USAID/Rwanda acknowledges that the audit plan could have been made more clear in the program agreement. For this reason, USAID/Rwanda agreed per Recommendation 1 to amend the program grant agreement.

However, USAID/Rwanda strongly contests the statement in the Audit Report that, *"USAID/Rwanda had not scheduled audits to verify that local currencies were used for authorized purposes"* (page 32). The exact same sentence appears again on page 33. In KIGALI 03485, dated August 16, 1991, USAID/Rwanda sent RIG/A/N a list of audits the Mission planned to conduct which included this specific audit. Similarly, when the RIG/A/N team was in Kigali in November 1992, USAID/Rwanda staff provided a draft PIO/T (with the funds available stamp) for an audit of the PMPR's local currency component. Indeed, the Audit Report even acknowledges that USAID/Rwanda did have an audit scheduled in the Mission's Audit Plan (page 34).

Likewise, USAID/Rwanda strongly contests the statement in the Audit Report that, *"USAID/Rwanda did not have reasonable assurance that the local currency equivalent of $1.05 million (Rwf 125 million) disbursed from the special account as of September 17, 1992 was used for intended purposes"* (highlight, page 34, and in text page 34). USAID/Rwanda has had reviews and discussions with Ministry of Finance staff on the eligibility criteria for both the dollars and local currency. USAID/Rwanda also works with Ministry staff to educate them on A.I.D. procedures -- with the full agreement from the GOR that if errors were found later in the financial reviews and audits, the GOR would reimburse the Special Local Currency Account. The same principle applies to the use of the dollars and reimbursements to the Special Dollar Account at Citibank.

USAID/Rwanda has reasonable assurance that the monies, both local currency and dollars, will be spent as intended. The good intention of the GOR has been demonstrated. The factual evidence is that as a result of USAID/Rwanda's financial review of the use of dollars by the central bank, errors in interpreting A.I.D. regulations were found. The ineligible uses of the dollars were explained to GOR officials. Then central bank reimbursed the Special Dollar Account for those errors, as called for in the program agreement. The reimbursements reflect more clearly than words the GOR's intent to comply with the letter and intent of the PMPR program it signed with USAID/Rwanda.

Consequently, the notion that because the language for providing for an audit was not in the program agreement USAID/Rwanda did not have reasonable assurances that the local currency is being used for intended purposes is fundamentally flawed. It ignores all the other elements that constitute a program and the actual events to date in Rwanda.

SECTION I. GENERAL COMMENTS ON AUDIT REPORT

- The Audit Report and cover letter are silent on the *Representation Letter* signed by the Mission Director and given to the Director of RIG/A/N during his November trip to Rwanda. Please explain as USAID/Rwanda has not been notified by RIG/A/N or IG whether or not the representation letter was acceptable.

- The summary in the Audit Report should be modified to reflect that this program was designed, reviewed, and approved during the time when the two new sets of local currency guidance were issued. Thus, all concerned were working with newly issued guidance as opposed to long-standing well-understood guidance. This point was noted in the USAID/Director to RIG/A/N/Director Memo, dated December 4, 1992, page 1 and has been incorporated on page 3 of the Audit Report, but not up-front in the summary. The Mission still believes this is an important point; important enough to be included in the summary.

- RIG/A/N's definition of Audit Objective Three does not correspond to A.I.D. policy and guidance. Its discrepancy is particularly important since RIG/A/N Recommendations 2 through 5 result from this audit objective. On page 14 (and again on page iii), the Audit Objective is stated as, "*Did USAID/Rwanda ensure that local currency generations were deposited and quickly disbursed as required by A.I.D. policy and supplemental guidance?*" The first part of the statement is consistent with A.I.D. policy and guidance and, in the case of Rwanda, this causes no difficulty as the generations were deposited according to the terms of the program agreement.

The second part of the statement, "*... quickly disbursed as required by A.I.D. policy and supplemental guidance?*" is not consistent with A.I.D. policy. A.I.D. Policy Determination 18 (PD-18) states, "*In general, jointly programmed ... local currency should be disbursed as quickly as is consistent with sound programming and prevailing economic conditions in the recipient country.*" A.I.D. Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency (STATE 204855, para 5.2) contains the exact same statement as PD-18, but adds a further qualification, as follows, "*... taking into account the conditions of an economic stabilization program that may have been negotiated.*"

Thus, the Audit Report states a *"requirement"* whereas A.I.D. policy and supplementary guidance do not. A.I.D. policy explicitly acknowledges that there are likely to be cases where a *"requirement"* of rapid disbursement could be counterproductive to sound programming and prevailing conditions. Consequently, the definition of the audit objective should be rewritten to be consistent with, rather than to be interpretative of, A.I.D. policy. If the intent of the policy is to require, then A.I.D. should change policy to make this clear. Until then, missions should not be held to standards inconsistent with policy. USAID/Rwanda firmly believes that it makes good sense to slow disbursements when the learning curves prove to be steeper than expected and when prevailing conditions indicate. The current A.I.D. policy and supplementary guidance should not, in USAID/Rwanda's view, be changed.

- When the changes are made to the recommendations, RIG/A/N should also examine the associated text so as to make it consistent with the revised recommendations. This is particularly the case for Recommendation No. 6.

- There are a number of typos and editorial needs throughout the Audit Report. For example, page ii, line 2, states, "singed" rather than "signed," and the sentences at the bottom of page 15 are not comprehensible.

Conclusion

Again, the Mission appreciates RIG/A/N role in identifying and raising important design and implementation issues applicable to the USAID program in Rwanda. If you or your staff have any further questions, please do not hesitate to contact me.

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