PD-ABG-604

Regional Inspector General for Audit
Nairobi, Kenya

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

Report No. 3-632-93-11
July 30, 1993


INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

July 30, 1993

Regional
Inspector General
for Audit/Nairobi

**MEMORANDUM**

**TO** : USAID/Lesotho Director, F. Gary Towery

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

**SUBJECT:** Audit of USAID/Lesotho's Management of Host Country-Owned Local Currency

Enclosed are five copies of our audit report on USAID/Lesotho's Management of Host Country-Owned Local Currency, Report No. 3-632-93-11.

We reviewed your comments on the draft report and included them as an appendix to this report. Recommendation Nos. 1, 2, and 3 are resolved but not closed. These recommendations will be closed when appropriate actions are completed. Please respond to this report within 30 days and provide the information cited on pages 19 and 20 of this report as a basis for closing Recommendation Nos. 1, 2, and 3.

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 302 · Fax: (254)-2-213551

# EXECUTIVE SUMMARY

## Background

The overall purpose of the Lesotho Primary Education Program (PEP) (Program) is to improve the quality and efficiency of primary education through the establishment of a new policy framework and reformed institutional structure. The Program's purpose is to be achieved through A.I.D. providing $18.6 million for sector assistance and $6.4 million for project assistance. The Government of Lesotho is expected to deposit the local currency equivalent of $18.6 million to be made available for the Ministry of Education's Sector Development Plan and a USAID trust fund (see page 1).

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. 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 page 1).

The PEP Program was designed during the transition to PD-18 as follows: the Program Assistance Identification Proposal was signed on October 19, 1989, and the Program Assistance Approval Document (PAAD) was signed on August 30, 1991 and the program grant agreement was signed on September 3, 1991. PEP's program assistance completion date is August 31, 1997 (see page 2).

## Audit Objectives

We audited the PEP Program 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 February 19 through May

7, 1993[1] to answer the following audit objectives:

1. Did USAID/Lesotho assess the accountability environment in the host country as required by A.I.D. policy and supplemental guidance? (See page 7.)

2. Did USAID/Lesotho design the grant agreements and amendments in accordance with A.I.D. policy and the supplemental guidance? (See page 9.)

3. Did USAID/Lesotho ensure that local currency generations were deposited and quickly disbursed as required by A.I.D. policy and supplemental guidance? (See page 11.)

4. Did USAID/Lesotho ensure that local currencies were programmed and used for the intended purposes as required by A.I.D. policy and supplemental guidance? (See page 14.)

5. Did USAID/Lesotho ensure that the impact of the local currency programs will be evaluated in accordance with A.I.D. policy and supplemental guidance? (See page 17.)

## Summary of Audit

The audit found that USAID/Lesotho: (1) assessed the accountability environment in the host country, (2) included provisions in the grant agreement for (a) a special account (b) the dollar amount of assistance and equivalent local currency to be deposited (c) deposit of local currency in an interest-bearing account (d) reporting on the special account and (e) auditing the special account, (3) adopted the general sector programming option which is acceptable under PD-18, and (4) ensured the impact of the Program would be evaluated, in accordance with A.I.D. policy and supplemental guidance.

However, the rate of disbursement to date showed that it is unlikely the Government of Lesotho will disburse local currencies deposited in the special local currency and general Treasury accounts quickly. In addition, USAID/Lesotho had not (1) received a report from the Ministry of Education which reflected both budget allocation and expenditure of funds for the Education Sector Development Plan and (2) ensured that the Ministry of Education established a date for conducting the first audit of the local currency deposited in the special account.

As a result, about $4.6 million (about 13 million Maloti) of the local currency deposit of about 15.5 million Maloti from the first tranche of about $6.1 million had not been disbursed from the special account and about $0.6 million (about 1.6 million Maloti) had not been disbursed from the Treasury general account. Also, USAID/Lesotho (1) did not have available a primary internal control tool for monitoring the use of expenditures against the budgeted amounts and (2) had not verified that the local currency equivalent of about $1.3 million (about 3.6 million

[1] Field work in Lesotho took place on two occasions: February 19 to March 5 and April 27 to May 7, 1993.

Maloti) disbursed from the special account was used for the Education Sector Development Plan.

## Audit Findings

**Assessment of the Accountability**
**<u>Environment In the Host Country</u>**

USAID/Lesotho assessed the accountability environment in the host country as required by A.I.D. policy and supplemental guidance. In October 1991, the USAID conducted a general assessment which concluded that the Government of Lesotho had established accounting and funds disbursement systems and procedures but the Ministry of Education's financial management capacity needed to be strengthened. USAID/Lesotho conducted an informal assessment of the Central Bank of Lesotho, which is the Government agency responsible for managing the special account. The basis for conducting an informal assessment, instead of a formal financial assessment, was the positive experience which the USAID had with the Central Bank in the management of a special account under a different program (see pages 7 and 8).

**Design of the Grant**
**<u>Agreement and Amendments</u>**

USAID/Lesotho designed the grant agreement and amendments for PEP in accordance with A.I.D. policy and supplemental guidance by including the provisions for a separate local currency account, the dollar amount of assistance which will generate local currency and the exchange rate used to express the amount in terms of local currency, deposit of local currency in an interest-bearing account, reporting by the host government agency responsible for managing the special account, and audit of the special account (see pages 9 and 10).

**Generation, Deposit and**
**<u>Disbursement of Local Currency</u>**

USAID/Lesotho ensured local currency equivalent to the first tranche of about $5.5 million was deposited into a special account in accordance with A.I.D. policy and supplemental guidance. However, the rate of disbursement to date showed that it is unlikely the Government of Lesotho will quickly disburse local currencies deposited in the special and general Treasury accounts as planned and budgeted for the Education Sector Development Plan. As a result, local currency equivalent to about $4.6 million (about 13 million Maloti) remained idle in the special local currency account and the equivalent of about $0.6 million (about 1.6 million Maloti) remained idle in the general account in the Treasury and was not used for program purposes (see pages 11, 12, and 13).

**<u>Local Currency Programming and Use</u>**

USAID/Lesotho ensured that local currencies were programmed as required by A.I.D. policy and supplemental guidance except that it had not received reports and had not ensured that the

Ministry of Education scheduled an audit to monitor and to verify that local currencies were used for the Education Sector Development Plan. As a result, USAID/Lesotho did not have available a primary internal control tool for monitoring the use of expenditures against the budgeted amounts and had not verified that the local currency equivalent of about $1.3 million (about 3.6 million Maloti) was used for the Education Sector Development Plan (see pages 14, 15 and 16).

**Impact Evaluation of the**
**Local Currency Program**

USAID/Lesotho 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/Lesotho developed performance indicators and included them in the PEP Program grant agreement. The agreement also provided for two external assessments of program impact to be conducted jointly by the World Bank and USAID/Lesotho (see page 17).

## Summary of Recommendations

The report contains three recommendations to correct problem areas identified. First, the report recommends that USAID/Lesotho communicate to the Government of Lesotho the slow disbursement of local currency from the special account and the Treasury general account and inform the Government that this issue will be included in the scope of work in the first program evaluation. Second, the report recommends that USAID/Lesotho require the Ministry of Education to revise its quarterly report on Education Sector Development Plan disbursements to include both budget allocation and expenditures of funds. Third, the report recommends that USAID/Lesotho ensure the Ministry of Education establishes a date for conducting the first audit of the special local currency account and use this date to schedule subsequent annual audits (see pages 12, 14, and 16).

## Management Comments and Our Evaluation

USAID/Lesotho agreed with the draft report's findings and recommendations. Management comments, which can be found in their entirety as Appendix II, were considered in preparing the final report. Recommendation Nos. 1, 2, and 3 are resolved but not closed (see pages 19 and 20 and Appendix II).

Office of the Inspector General

Office of the Inspector General
July 30, 1993

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**APPENDICES**

# INTRODUCTION

## Background

The purpose of the Primary Education Program (PEP) (Program) is to improve the quality and efficiency of primary education through the establishment of a new policy framework and reformed institutional structure. The Program's purpose is to be achieved through A.I.D. providing $25 million in Development Fund for Africa funds of which $18.6 million will be for sector assistance and $6.4 million will be for project assistance.

Cash transfer dollar assistance will be disbursed in four tranches upon the satisfaction of the specified conditions precedent for education reforms to each disbursement. In turn, and for at least two years, the Central Bank of Lesotho will deposit in a special local currency account and a USAID trust fund the equivalent in Maloti of the dollar disbursement, using the highest commercial exchange rate in effect on the date of the dollar disbursement.

Ninety percent of the Government of Lesotho-deposited local currency associated with U.S. dollar releases for satisfactory performance on sectoral reforms and any local currency interest accumulations will be used for education budget support. USAID and the Ministry of Education (MOE) will jointly program the local currency on a annual basis to support the implementation of the Education Sector Development Plan, which includes the World Bank and the European Economic Community as participants. The amount of local currency expected to be available for the Development Plan is the Maloti equivalent of $16.74 million[2], plus any accumulated interest, or less if local currency deposits are not required after two years. Additionally, USAID project assistance totalling $6.4 million will directly support implementation of the Development Plan reforms.

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.

[2] Excludes the Government of Lesotho-deposited Maloti equivalent of $1.86 million for USAID trust fund.

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 PEP Program was designed during the transition to PD-18 as follows: the Program Assistance Identification Proposal was signed on October 19, 1989, and the Program Assistance Approval Document (PAAD) was signed on August 30, 1991, and the program grant agreement was signed on September 3, 1991. The PEP's program assistance completion date is August 31, 1997.

## Audit Objectives

The Office of the Regional Inspector General for Audit/Nairobi audited USAID/Lesotho's Management of Host Country-Owned Local Currency (specifically, USAID/Lesotho's Primary Education Program) 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/Lesotho was selected for audit because it was one of those missions which were further along in implementing the new policy. The PEP was selected for audit because it was the only non-project assistance agreement in USAID/Lesotho signed after July 1, 1991, the date PD-18 and the supplemental guidance became effective. Our field work was conducted from February 19 through May 7, 1993[3] to answer the following audit objectives:

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

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

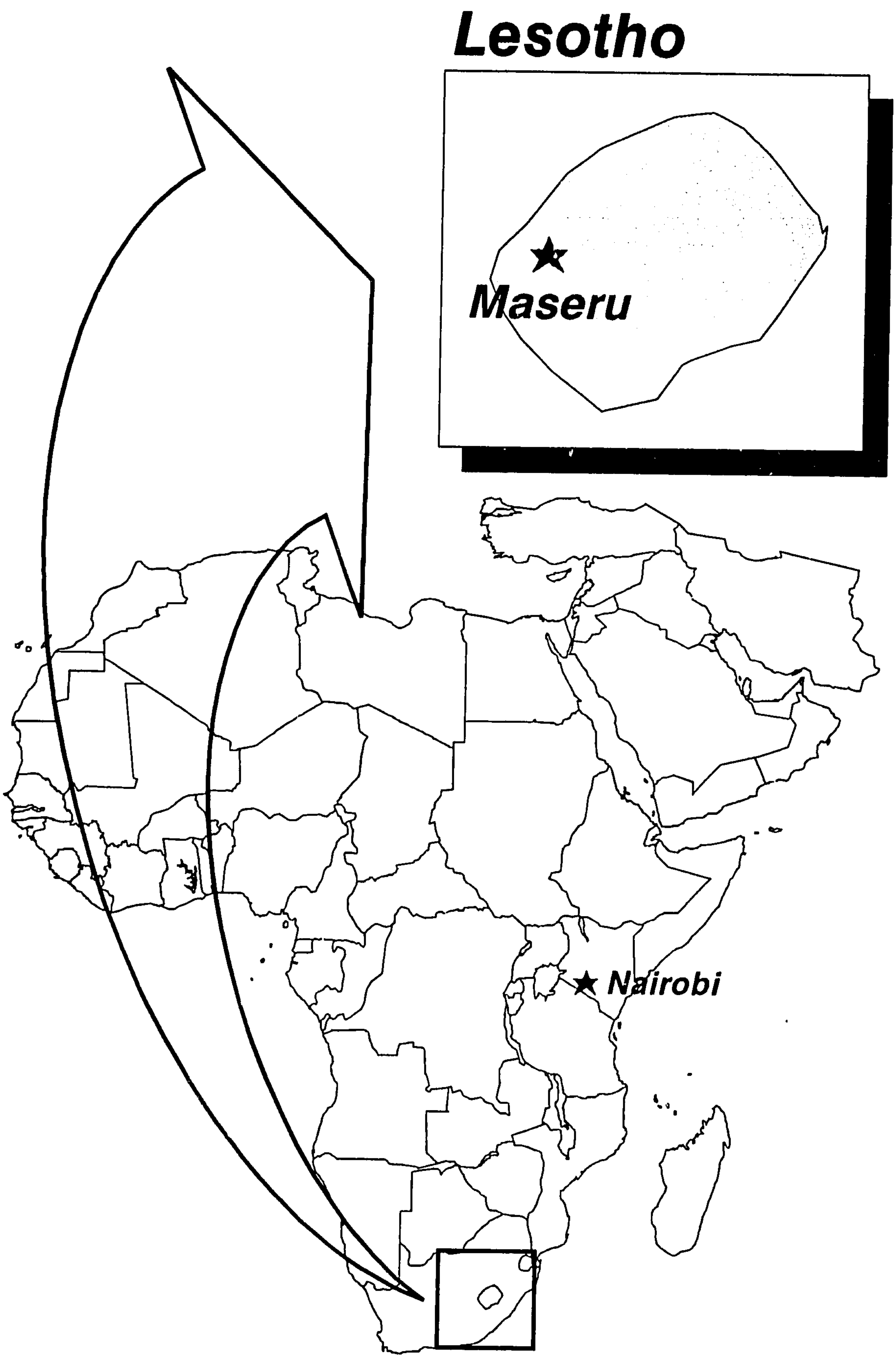
[3] Field work in Lesotho took place on two occasions: February 19 to March 5 and April 27 to May 7, 1993.

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

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

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

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# REPORT OF AUDIT FINDINGS

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

USAID/Lesotho 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.

Section 5.1.A.1 of State cable No. 204855, requires USAID offices to 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/Lesotho conducted in October 1991 a general assessment of the existing accounting and funds disbursement systems and procedures of the Government of Lesotho. On the basis of this general assessment, the PAAD for the Primary Education Program (PEP) dated August 30, 1991 concluded that the Government of Lesotho had established general procedures but that the Ministry of Education's financial management capacity needed to be strengthened. Further, the PAAD conditioned the initial disbursement of sector assistance on the Ministry of Education's commitment to dedicate resources to improve its capability to manage the allocated funds satisfactorily. Actions include the Ministry of

Education's agreement to obtain a long-term project-financed expatriate financial management adviser. USAID/Lesotho procured the expatriate financial adviser as part of its contribution to the Program; the adviser arrived Lesotho in November 1992.

Also, USAID/Lesotho conducted an informal assessment of the Central Bank of Lesotho, which is the Government agency responsible for managing the special local currency account. The basis for conducting an informal assessment, instead of a formal financial assessment, was the positive experience which the USAID had with the Central Bank in the management of a special account under a different program. The informal assessment stated that the Central Bank has had oversight and control responsibility for the Government of Lesotho-deposited local currency and has thus far demonstrated capacity to manage the funds properly. Further, the PAAD stated that the Central Bank's accounts are audited annually by the Government of Lesotho Auditor General or an accounting firm under contract to the Auditor General.

USAID/Lesotho did not include as part of the financial analysis section of the PAAD a detailed specific assessment of appropriate programming alternatives available to the mission based on the general assessment. However, we did not consider this omission significant to the implementation of the program since USAID/Lesotho had otherwise complied with A.I.D. policy and supplemental guidance in assessing the accountability environment in the host country.

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

USAID/Lesotho designed the grant agreement and amendments in accordance with A.I.D. policy and supplemental guidance.

Section 4.2 of Policy Determination No. 18 (PD-18) and section 3.0 of State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency," require local currency to be deposited into a special account. Section 3.1 of the supplemental guidance requires that the grant agreement contain 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. According to section 5.6 of PD-18 and section 5.2 of the supplemental guidance, A.I.D. policy favors that local currency be placed in interest-bearing accounts. In addition, according to section 6.3 of PD-18 and sections 5.1.B of the supplemental guidance, the program grant agreement must provide for appropriate reporting by the host government agency responsible for managing the special account. Further, section 6.3 of PD-18 requires provision for audit of the special account, and according to section 5.1.C.1 of the supplemental guidance, the Program Assistance Approval Document (PAAD) should contain a discussion of the ability of the host government's agency to conduct an independent, fair and impartial audit.

In accordance with the requirements of PD-18 and the supplemental guidance, USAID/Lesotho included the following provisions in the grant agreement:

- establishment of a separate local currency account for the Primary Education Program (PEP);

- the dollar amount for each tranche, and the requirement that within one day after release of each tranche, an equivalent amount of local currency be deposited based on the highest commercial rate of exchange which is not unlawful in Lesotho on the date of the dollar transfer;

- deposit of local currency into an interest-bearing account;

- four reports from Government of Lesotho (GOL) on the local currency: a monthly bank statement of the special local currency account from the Central Bank of Lesotho; a monthly bank reconciliation by the Ministry of Education (MOE) based on the bank statement from the Central Bank; a monthly statement from the Central Bank on deposits into the MOE account; and a quarterly report from MOE showing disbursements against the agreed-upon budget. A problem associated with the submission of the quarterly report is discussed under Audit Objective Four.

- an annual audit of the special local currency account by the GOL Auditor General. Although the PAAD did not contain a discussion of the Auditor General's ability to conduct independent, fair and impartial audits, the grant agreement stated that this assessment would be conducted during the first year of the program. The assessment was conducted in March 1992 in compliance with the grant agreement, and concluded that the Auditor General did not have the capability to conduct the required audits. The audits will therefore be conducted by an external audit firm. A problem associated with scheduling the audit of the special local currency account is discussed under Audit Objective Four.

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

USAID/Lesotho ensured that local currencies were deposited into a separate interest-bearing account as required by A.I.D. policy and supplemental guidance. However, the rate of disbursement to date showed that it is unlikely these local currencies will be disbursed quickly from the account as planned and budgeted for the Education Sector Development Plan.

Section 4.2 of Policy Determination No. 18 (PD-18) and section 3.0 of State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency," require that local currency be deposited into a special account. In addition, section 7.1 of PD-18 gives A.I.D. the authority to establish trust fund accounts for host country-owned local currency. Also, according to section 5.6 of PD-18 and section 5.2 of the supplemental guidance, A.I.D. favors that local currency be placed in interest-bearing accounts. Further, section 3.1 of the supplemental guidance requires that the grant agreement contain 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.

USAID/Lesotho ensured that local currency equivalent to the first tranche of about $5.5 (about 15.5 million Maloti) was generated and deposited into a special account, which was interest-bearing, at the Central Bank of Lesotho. Also, in accordance with A.I.D. policy, the grant agreement contained the dollar assistance which was to generate local currency and the rate of exchange which was to be applied. The total dollar assistance that generated local currency was about $6.1 million, out of which, the equivalent of about $0.6 million was deposited into a trust fund account, in compliance with the terms of the grant agreement.

However, the rate of disbursement to date showed that it is unlikely local currencies will be disbursed quickly from the special account. This problem is discussed below.

### Local Currency Funds
### <u>Unlikely to be Disbursed Quickly</u>

According to A.I.D. policy, programmed local currency should be disbursed quickly. However, the rate of disbursement to date showed that it is unlikely the Government of Lesotho (GOL) will quickly disburse local currencies deposited in the special local currency and general Treasury accounts as planned and budgeted for the Education Sector Development Plan. The slow rate of disbursement was caused by construction delays experienced by the World Bank's segment of the Plan's project and the late arrival of the A.I.D.-financed technical assistance team to the MOE. As a result, local currency equivalent to about $4.6 million (about 13 million Maloti) remained idle in the special local currency account and the equivalent of about $0.57 million (about 1.6 million Maloti) remained idle in the general account in the Treasury and was not used for program purposes.

**<u>Recommendation No. 1:</u> We recommend that USAID/Lesotho communicate to the Government of Lesotho the slow disbursement of local currency from the special account and the general Treasury account and inform the Government that this issue will be included in the scope of work for the first program evaluation.**

Section 5.6 of Policy Determination No. 18 states that jointly 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 15 months.[4]

The first tranche of about $6.1 million for the Primary Education Program was released on May 20, 1992. On the same date, and in accordance with the grant agreement, the GOL deposited the local currency equivalent (about 15.5 million Maloti) at the Central Bank of Lesotho. On June 30, 1992, about 3.6 million Maloti was transferred from the special local currency account at the Central Bank to the MOE's general account at the Treasury for use in the Education Sector Development Plan.

However, the amount of local currencies disbursed to date shows a trend that it is unlikely the GOL will disburse all the local currencies from the first tranche prior to the second tranche. Therefore, we concluded that the disbursements of local currencies would not be made quickly as we defined above. Only the initial 3.6 million Maloti had been disbursed from the special account and about 2 million Maloti disbursed from the general Treasury account over a 9-month period[5], and no further transfers had been made from the special account to the general Treasury account as of March 31, 1993. According to the grant agreement, the second tranche was to have been released by April 1993; but this date was later revised because conditions precedent had not been satisfied. The revised implementation schedule shows that the second tranche of $5.5 million will be released to the GOL in August 1993, which will require the GOL to deposit an equivalent amount of local currency in the special account.

The slow disbursement of local currency in both the special local currency account and the general Treasury account was primarily caused by the construction delays experienced by the World Bank segment of the project[6]. The Ministry of Public Works needed to provide a waiver

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[4] This definition is our own. It is based on the 15-month period of time from deposit of the local currency equivalent to the first tranche of about $5.5 million on May 20, 1992 until the deposit of the second tranche scheduled in August 1993.

[5] Although the program grant agreement allowed local currency generated from A.I.D. funds to be commingled with other donor funds in a Treasury general account, the MOE's accounting system recorded each donor's expenditures from this account separately.

[6] Program Implementation Letter No. 9 included a budget of about 38.2 million Maloti and showed how these funds would be allocated across 15 categories of expenditures for the fiscal year 1992/1993. Expenditures related to construction comprise about 46 to 49 percent of the planned budget. However, an MOE report provided to USAID/Lesotho on disbursements showed only about 4 million Maloti spent during the period ending March 31, 1993.

before contracts could be awarded to the Lesotho community to begin construction[7]. Another contributory factor to the slow rate of disbursement was the late arrival of the A.I.D.-financed technical assistance team to the MOE. The financial advisor for the technical assistance team did not arrive until November 1992.

The special local currency account at the Central Bank is interest bearing (see page 15) thus, reducing, to some extent, any adverse impact resulting from slow disbursement of local currency from the first tranche. However, about $4.6 million (about 13 million Maloti) of the local currency deposit of about 15.5 million Maloti of the first tranche plus accrued interest remained idle in the special account and no further transfers had been made from the special account to the general Treasury account over a 9-month period ending March 31, 1993. Furthermore, about $0.57 million (about 1.6 million Maloti) remained idle in the Treasury general account and was not used by the MOE for the Education Sector Development Plan.

Based on the above, we concluded that USAID/Lesotho should communicate to the GOL the slow disbursement of local currency from the special account and the Treasury general account and inform the Government that this issue will be included in the scope of work for the first program evaluation.

Although USAID/Lesotho officials told the auditors at the exit conference on May 7, 1993 that the achievement of policy reforms within the Ministry of Education rather than local currency disbursement was the most important aspect of the PEP program, the Mission informed the Deputy Principal Secretary of the MOE on April 1, 1993, that a very significant problem had been detected by the auditors regarding the amounts and rate of disbursements of USAID-provided grant funds under the Education Sector Development Plan. Mission officials asked the Deputy Principal Secretary to inform them of steps that the MOE is now taking or about to take to speed up the disbursement of funds. To close Recommendation No. 1, USAID/Lesotho needs to communicate to the Government that the issue of slow disbursement of funds will be included in the scope of work for the first program evaluation scheduled for January-March 1994.

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[7] The Ministry of Public Works provided the MOE a signed waiver on March 16, 1993. Actual construction is not expected to start until July 1993.

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

USAID/Lesotho ensured that local currencies were programmed as required by A.I.D. policy and supplemental guidance but had not been able to verify that local currencies were used for the Education Sector Development Plan as required by A.I.D. policy and supplemental guidance.

Section 6.1 of State cable No. 204855 entitled "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/Lesotho programmed all local currency generations from the first tranche for general sector support in accordance with A.I.D. policy.

However, USAID/Lesotho had not received reports and had not scheduled an audit to monitor and to verify that local currencies were used as intended. The problems with monitoring and verifying use of local currencies are discussed below.

**USAID/Lesotho Has Not Received Reports**
**Needed to Monitor Use of Local Currencies**

According to section 6.3.B.2 of State cable No. 204855, missions should ensure that reports on use of local currency reflect both budget allocation and expenditure of funds from the general fund. However, USAID/Lesotho had not received a report from the Ministry of Education (MOE) which reflected both budget allocation and expenditure of funds for the Education Sector Development Plan. The MOE had not provided the required report because its accounting system could not easily provide the necessary financial data needed to produce the report and the late arrival of the project-funded financial management adviser to Lesotho. As a result, USAID/Lesotho did not have available a primary internal control tool for monitoring the use of expenditures against the budgeted Plan amounts.

> **Recommendation No. 2: We recommend that USAID/Lesotho ensure the Ministry of Education provides quarterly reports on Education Sector Development Plan disbursements that include both budget allocation and expenditures of funds.**

Section 6.3.B.2 of State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency," states that any agreement between the host government and A.I.D. concerning use of local currency for general sector support should specify the format and frequency of reports to be made to A.I.D. under this type of program. The agency managing the special account will be responsible for verifying that documentation exists demonstrating that the local currency indeed was transferred from the special account to the general fund and to a Ministry's account or budget line-item. The reports should reflect both budget allocation and expenditure of funds from the general fund.

USAID/Lesotho included provisions in the grant agreement concerning use of local currency for general sector support and specified the format and frequency of reports to be made to the USAID. However, USAID/Lesotho had not received a report from the MOE which showed both budget allocation and expenditure of funds from the general fund as required by the program agreement[8].

The MOE had not provided the required report because its accounting system could not easily provide the financial data required by the report format and the late arrival of the project-funded financial management adviser precluded his technical assistance in developing the quarterly report.

As a result, USAID/Lesotho did not have available for its use a primary internal control tool for monitoring expenditure of funds (about 4 million Maloti for all donors as of March 31, 1993) for the Education Sector Development Plan against the multi-donor budget (about 38.2 million Maloti for April 1, 1992 through March 31, 1993).

Based on the above, we concluded that the quarterly report should be revised to show both budget allocation and expenditure of funds. On April 1, 1993, USAID/Lesotho requested the Deputy Principal Secretary of the MOE to revise the quarterly report to show the amount budgeted for the Education Sector Development Plan and amounts expended. USAID/Lesotho received a revised report dated May 4, 1993 but the product showed the financial data in a format different from that required by the format contained in Program Implementation Letter (PIL) No. 9 and the report was not complete because the budget column showed only the total amount rather than budget amounts by line item. In order to close Recommendation No. 2, USAID/Lesotho will have to issue a PIL to revise the reporting format or structure the report as required by PIL No. 9.

**USAID/Lesotho Has Not**
**Scheduled Required Audits**

According to section 5.1.C of State cable No. 204855, missions should ensure that special local currency accounts are audited periodically. While the program grant agreement contained audit provisions, USAID/Lesotho had not ensured that the MOE scheduled an audit of local currency deposited in the special local currency account. USAID/Lesotho had not ensured the required audits were scheduled because the date of the annual audit was not defined in the program grant agreement and the implementation schedule contained in the program grant agreement and a later revised schedule did not include an action item for performing audits. As a result, USAID/Lesotho had not verified that the local currency equivalent of about $1.3 million (about 3.6 million Maloti) was used for the Education Sector Development Plan.

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[8] The MOE provided its first quarterly report to USAID/Lesotho on February 23, 1993. The report only showed the amount of expenditures for the Education Sector Development Plan for the period February through December 31, 1992.

**<u>Recommendation No. 3:</u> We recommend that USAID/Lesotho ensure the Ministry of Education establish a date for conducting the first audit of the special local currency account and use this date to schedule subsequent annual audits.**

Section 5.1.C of State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency," states that missions should ensure that special local currency accounts are audited periodically. At the Program Assistance Approval Document (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.

USAID/Lesotho included provisions for auditing the special account and required the MOE to audit the management of funds for Education Sector Development Plan disbursements on an annual basis. However, USAID/Lesotho had not ensured that the MOE scheduled an audit of the local currency special account[9] to verify that local currencies have been used for the Education Sector Development Plan.

USAID/Lesotho had not ensured the required audits were scheduled because the date of the first annual audit was not defined in the program grant agreement and the implementation schedule contained in the amplified program description of the program grant agreement did not include an action item for performing audits. Also, due to an oversight, an action item was not included in the revised implementation schedule contained in Program Implementation Letter No. 10, which was approved on December 7, 1992.

As a result of not scheduling an audit, USAID/Lesotho had not verified that the local currency equivalent of about $1.3 (about 3.6 million Maloti) disbursed from the special account to the Treasury general account on June 30, 1992 was used for the Education Sector Development Plan.

Based on the above, we concluded that USAID/Lesotho needed to schedule an audit to cover all disbursements from the special account and ensure that audits are performed annually thereafter. On April 1, 1993, USAID/Lesotho requested the Deputy Principal Secretary of the MOE to make arrangements for an audit of the special account. At the conclusion of field work on May 7, 1993, the MOE had requested the Lesotho Auditor General for a list of qualified auditing firms but still had not scheduled the audit. Recommendation No. 3 will be closed on the Regional Inspector General for Audit/Nairobi receipt of a signed engagement letter between the recipient's auditing firm and the auditee.

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[9] The Central Bank of Lesotho deposited the local currency equivalent of about $5.5 million (about 15.5 million Maloti) on May 20, 1992.

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

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

Section 7.0 of State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency," states 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. These performance indicators must be verifiable. The supplemental guidance provides further clarification on the nature of performance indicators and states that these indicators, like monitoring responsibilities, reflect the complexity of the program. Thus, performance indicators for projects will likely be very specific measures of project outputs; on the other hand, those for general sector support may simply demonstrate an increase in the level of funding for a sector.

USAID/Lesotho developed performance indicators and included them in the Primary Education Program (PEP) grant agreement. The conditions precedent for each tranche specified the required level of Government of Lesotho (GOL) budgetary allocation to the Primary Education sub-sector in the Ministry of Education (MOE). In addition, the conditions precedent for the release of each tranche detailed measurable actions required of the MOE, for instance, the number of additional primary teacher positions that needed to be created and filled, and the number of District Resource Teachers that needed to be recruited and posted. These indicators were intended to measure the impact of A.I.D.'s contribution to GOL's Education Sector Development Plan. To cater to the overall multi-donor program, the grant agreement provided for two external assessments of program impact to be conducted jointly by the World Bank and USAID/Lesotho over the life of the program.

# MANAGEMENT COMMENTS AND OUR EVALUATION

USAID/Lesotho agreed with 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/Lesotho 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 - to communicate to the Government of Lesotho the slow disbursement of local currency from the special account and the general Treasury account and to inform the Government that this issue will be included in the scope of work for the first program evaluation (see page 12). The Mission acknowledged that the disbursement of funds is slow and that a large portion of funds from the first tranche remain in the special local currency account. After the auditors' first field visit in February 1993, USAID/Lesotho officials discussed the issue of slow disbursement of local currencies with appropriate Ministry of Education (MOE) officials on several occasions. Also, the Mission sent a letter to the Deputy Principal Secretary of the MOE on April 1, 1993 that reported the slow disbursement problem which had been detected by the auditors. In addition, the Mission's response stated the subject of slow disbursement will be a topic at the annual joint USAID/World Bank review scheduled for late August 1993. Based on the Mission's actions, we consider Recommendation No. 1 resolved. We will close the recommendation on receipt of documentation showing the Mission had communicated to the Government of Lesotho the Mission's intention to make the issue of slow disbursement of funds a part of the first program evaluation scheduled for early 1994.

• Recommendation No. 2 - to obtain from the Ministry of Education a revised quarterly report on Education Sector Development Plan disbursements that includes both budget allocation and expenditures of funds (see page 14). After the auditors' first field visit, the Mission, in its letter of April 1, 1993 to the Deputy Principal Secretary of MOE, requested officials to revise the quarterly report to show the amount budgeted for the Education Sector Development Plan and amounts expended. Therefore, we consider Recommendation No. 2 resolved. However, at the conclusion of field work on May 7, 1993, the MOE still had not provided the Mission a quarterly report in a format as outlined in Program Implementation Letter (PIL) No. 9. USAID/Lesotho expects to receive a report on expenditures against budgeted Education Sector Development Plan amounts by mid-July 1993. We will close the recommendation on receipt of (1) a PIL to revise the reporting format and a quarterly report showing both budget allocation and expenditures by category or (2) a quarterly report showing budget categories corresponding to those of PIL No. 9 and each category showing both budget allocation and expenditures.

•Recommendation No. 3 - to ensure the Ministry of Education establish a date for conducting the first audit of the special local currency account and use this date to schedule subsequent annual audits (see page 16). The Mission acknowledged that an audit of the special local currency account had not been scheduled. After the auditors' first field visit, the Mission, in its letter of April 1, 1993 to the MOE, requested the Ministry to make arrangements for an audit of the special currency account. Therefore, we consider Recommendation No. 3 resolved. We commend the timely action taken by the Mission to formally communicate the problem with scheduling the audit a full three months before the program grant agreement required the audit to be performed. However, at the conclusion of field work on May 7, 1993, the MOE still had not scheduled the audit. Also, the Mission's comments did not indicate that the MOE had established a date for performing the first audit of the special local currency account. We will close the recommendation on receipt of a signed engagement letter between the recipient's auditing firm and the auditee.

# SCOPE AND METHODOLOGY

## Scope

We audited USAID/Lesotho's Management of Host Country-Owned Local Currency in accordance with generally accepted government auditing standards. We conducted the audit from February 19 to May 7, 1993 in the offices of USAID/Lesotho and covered the Primary Education Program (PEP) (Program). The PEP was the only non-project assistance agreement signed after the July 1, 1991 effective date of Policy Determination No. 18 and State cable No. 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency."

In performing our audit, we obtained documentary and testimonial evidence from the offices of USAID/Lesotho, and the Government of Lesotho Ministry of Education (MOE). 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 quickly 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/Lesotho's records, a total of about $10.0 million was obligated for the PEP Program, and about $6.1 million disbursed as of March 31,1993. The audit covered the entire local currency equivalent of about $5.5 million[10] (about 15.5 million Maloti) that was deposited into the special account on May 20, 1992 and the entire equivalent of about $1.3 million (about 3.6 million Maloti) withdrawn at the time of the audit.

As part of this audit, we reviewed USAID/Lesotho's internal control assessment. We also reviewed five prior RIG/A/N audit reports relating to host country-owned local currency --Audit Report Nos. 3-696-93-08 (Audit of USAID/Rwanda's Management of Host Country-Owned Local Currency), 3-612-92-14 (Malawi Enterprise Development), 3-615-92-03 (Kenya Commodity Import Programs), 3-687-92-01 (Madagascar Sector Assistance Programs), and 3-613-90-06 (Zimbabwe Local Currency Generations). There were no prior audit findings to review because the Lesotho PEP Program had not been previously audited.

We did not test the reliability of computer-generated data used in the report because: (1) the

[10] The audit did not cover the local currency equivalent of about $0.6 million deposited into a trust fund account.

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/Lesotho's general development officer, the program resource manager and the Mission controller. Also, we reviewed the Program Assistance Approval Document (PAAD) to determine whether the Mission documented a conclusion on the capability of the Central Bank of Lesotho to effectively manage the special account. Further, we reviewed the PAAD to determine whether USAID/Lesotho had documented the basis for its decision to rely on an informal assessment, i.e. its favorable experience with the Central Bank 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 PEP 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 determined whether a special local currency account was established as required by PD-18 and the Supplemental Guidance, and whether local currency equivalent to about $5.5 million was deposited into this account. Also, we determined whether local currencies were deposited into an interest-bearing account.

To determine whether local currency generations were quickly disbursed as required, we documented the amount of local currency (about 15.5 million Maloti) deposited in the special account on May 20, 1992 and quantified the amount of withdrawals from the special account as of March 31, 1993. We then compared the local currency withdrawn from the special account up to that point, about 3.6 million Maloti, with the total amount that was available on March 31, 1993, about 13 million Maloti.

In addition, we interviewed PEP's program coordinator, the general development officer, the program resource manager and the Mission controller.

## Audit Objective Four

To accomplish this objective, we assessed whether local currency deposits 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/Lesotho was one of the four programming options given by PD-18, and discussed with USAID/Lesotho officials methods used to ensure that local currencies were used for intended purposes. Also, we reviewed Ministry of Education documentation showing what goods and services the local currencies paid for, and determined whether USAID/Lesotho used audits to ensure that local currencies were used for authorized purposes. We reviewed $262,787 (742,243 Maloti) out of the local currency equivalent of about $1.3 million (about 3.6 million Maloti) disbursed from the special local currency account as of March 31, 1993 to determine what goods and services were procured. This sample represented 37 percent of the value of all local currency disbursements from the general Treasury account (about 2 million Maloti) through March 31, 1993.

## Audit Objective Five

To accomplish this objective we assessed whether the impact of the PEP 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/Lesotho had made provision for the evaluation of the PEP program.

In addition we interviewed the general development officer, the program resource manager and the Mission controller.

# U.S. Agency For International Development
# memorandum

USAID

DATE: 21 July 1993

REPLY TO ATTN OF: F. Gary Towery, Mission Director

SUBJECT: Audit of USAID/Lesotho's Management of Host Country-Owned Local Currency

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

REF: June 11, 1993 Memo

The Mission appreciates the thorough job and excellent cooperation of the RIG/A Auditors who undertook the local currency audit of the Lesotho Primary Education Program. The Mission particularly appreciates the opportunity to review the draft reports in advance and the fact that Mission comments and concerns were duly considered at all stages. We acknowledge that our input at the exit conference is reflected in the most recent draft submitted to us under cover of your June 11 memo.

Mission comments are divided into two sections: general comments on the recommendations as well as some information on the steps/actions taken by the Mission to date to relay audit findings to the MOE and to work toward their resolution, and specific points of clarification or editorial comments.

GENERAL COMMENTS:

1. Mission comments regarding the first recommendation about the slow disbursement of funds from the special local currency account include the following two points of clarification:

   a) The report is written in such a way as to suggest that the slow disbursement of Tranche I has not been brought to the Ministry's attention. Only in the very last paragraph of this section, on page 19, is it brought out that the Mission already communicated this concern. In fact the Mission has discussed this issue with appropriate MOE officials on several occasions following the first field visit of RIG/A in February. Only the second part of the recommendation on communicating the intention to make slow disbursement a part of the first evaluation, schedule for early 1994, remains to be done.

b) The Mission acknowledges that the disbursement of funds is slow and that a large portion of Tranche I funds remain in the special local currency account. We appreciate the fact that the report now includes a paragraph on page 18 explaining that the slowness is in large part due to delays in awarding contracts for the World Bank construction components. World Bank personnel visited Lesotho at our request in March and addressed the procurement issues causing delays in program implementation. Now that these issues have been resolved we expect the pace of implementation to intensify. In addition slow disbursement will be a topic of the annual joint USAID/World Bank review scheduled for late August. As the Primary Education Program is funded with parallel financing from the World Bank, we recognize the need to work in close cooperation with our World Bank counterparts.

2. Reference the third recommendation on the audit of the special local currency account, we would like to make the following clarification:

   Although we acknowledge that an audit of the special local currency account called for in the RIG/A audit report had not been scheduled, we would like to point out that such an audit was requested by the Mission in its letter of April 1, 1993 to the Ministry. The Primary Education Program Grant Agreement calls for annual audits which normally means that the audit would occur only after completion of one year. Since the first disbursement of funds did not take place until June 1992, the first full year of expenditures out of this account only began on June 30, 1992, as the Report notes in third paragraph on page 17. Thus, the Mission's April 1, 1993 request to the MOE to arrange such an audit occurred a full three months before the audit would normally begin.

SPECIFIC COMMENTS:

1. Page ii, 2nd para.: Although the review may have been continuous, it is useful to point out that the field work took place on two occasions: February 19 to March 5 and April 27 to May 7, 1993.

2. Page iv, 2nd para.: The report states, "As a result, about $4.6 million (about 13 million Maloti) of the local currency deposit of about 15.5 million Maloti from the first tranche of about $6.1 million had not been disbursed from the Treasury general account." This sentence is out of context. Although it is correct, on page 19 where these figures are mentioned in the context of the slow disbursement of local currency in the special account, the facts of the preceding/first paragraph on page iv are not the reason for the slow disbursement of funds referred to in this paragraph.

3. Page 4, 2nd para.: Again it would help to clarify that in-country field work took place on two occasions as stated in comment 1 above.

4. Page 18, footnote 4: The Mission would appreciate knowing the source of the figure cited. "38.2 million Maloti". The only figure known to us was the M29.5 million figure found in the World Bank Advisor's internal report. But even her figure is being revised because she put some figures in the first

column which are actually for the full five years of the Program, thus giving a too-high total for just FY1993. The MOE Financial Controller's office is working on a correct total. The Mission expects to receive a correct total as well as a full financial report on expenditures against budgeted Education Sector Development Plan amounts by mid-July 1993.

5. Page 22, footnote 6: In our discussions with the Ministry of Education, the Financial Management Advisor in the Financial Controller's office has stated that expenditures are for the entire period since the MOE began implementing the Sector Plan, that is from February 1992. The report cited fails to make this reporting period clear. The Mission has called this problem to the attention of the MOE and they are amending their reports to reflect the correct time frame.

**Appendix III**

## Report Distribution

| | |
|---|---|
| American Ambassador to Lesotho | 1 |
| Director, USAID/Lesotho | 5 |
| AA/AFR | 1 |
| AA/OPS | 1 |
| AA/FA | 1 |
| AFR/SA/SALAN | 1 |
| AFR/CONT | 1 |
| XA/PR | 1 |
| LEG | 1 |
| GC | 1 |
| FA/FM | 1 |
| AA/R&D/PO | 1 |
| POL/CDIE/DI | 1 |
| FA/MCS | 2 |
| FA/FM/FPS | 2 |
| REDSO/ESA | 1 |
| REDSO/RFMC | 1 |
| REDSO/Library | 1 |
| IG | 1 |
| AIG/A | 1 |
| IG/A/PSA | 1 |
| IG/A/FA | 1 |
| IG/A/PPO | 3 |
| IG/LC | 1 |
| IG/RM | 12 |
| AIG/I&S | 1 |
| IG/I/NFO | 1 |
| RIG/A/B | 1 |
| RIG/A/C | 1 |
| RIG/A/D | 1 |
| RIG/A/S | 1 |
| RIG/A/T | 1 |
| RIG/A/EUR/W | 1 |