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AUDIT OF
PRICE WATERHOUSE ASSOCIATES ACTIVITIES
IN KENYA UNDER THREE A.I.D. CONTRACTS

AUDIT REPORT NO. 3-615-89-20
September 26, 1989

Contractor information contained in this report may be priviledged. The restrictions of 18 USC 1905 should be considered before any information is released to the public.

UNITED STATES OF AMERICA

AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT

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

INTERNATIONAL POSTAL ADDRESS
POST OFFICE BOX 30261
NAIROBI, KENYA

September 26, 1989

MEMORANDUM FOR DIRECTOR, USAID/KENYA, Steven W. Sinding

FROM: Richard C. Thabet, RIG/A/Nairobi Richard C Thabet

SUBJECT: Audit of Price Waterhouse Associates Activities in Kenya Under Three A.I.D. Contracts

The Office of the Regional Inspector General for Audit/Nairobi has completed its audit of Price Waterhouse Associates activities in Kenya under three A.I.D. contracts. Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you, the contracting officer and Price Waterhouse Associates for comment and your comments and those of Price Waterhouse Associates are attached to the report. The contracting officer, however, did not respond to our request to provide comments by the report issuance date. The report contains three recommendations. The recommendations are unresolved as both your response and the contractor's response did not specifically address or outline actions planned to implement Recommendation Nos. 1, 2 and 3. Please advise me within 30 days of your specific response or actions planned to implement the recommendations.

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

EXECUTIVE SUMMARY

Price Waterhouse Associates provided advisory, consulting, training and administrative services to the following three USAID/Kenya projects: (1) Commodity Import Program (2) Agricultural Management Project and (3) National Agricultural Research Project. Price Waterhouse Associate's involvement in the Commodity Import Program began in March 1985 and was to terminate in June 1989. The contract to provide services to the Agricultural Management Project was signed in March 1987 and was to expire in September 1989. Price Waterhouse Associates also contracted to provide services to the National Agriculture Research Project, which began in July 1988 and was scheduled to end in June 1995.

The Regional Inspector General for Audit, Nairobi made a financial audit of Price Waterhouse Associates' activities under the three contracts. The specific audit objectives were to determine whether: (1) overhead rate computations for three fiscal years ended June 30, 1988 were correctly computed and that costs billed A.I.D. were reasonable, allocable, allowable and in accordance with contract provisions, (2) the contractor's internal control procedures over contract funds were adequate and effective, and (3) A.I.D.-financed commodities were effectively controlled.

Costs billed A.I.D. were reasonable, allocable and allowable; except that costs totalling $163,822 were over-billed due to the difference between overhead rates that should have been charged as determined by the audit and the provisional overhead rates that were actually charged. Further, other costs totalling $59,388 were disallowed or questioned due to the contractor's overstatement of daily salary rates, errors in billing and lack of supporting documentation. In addition, the contractor's system of internal control was inadequate in several respects, and A.I.D.-financed commodities were not being effectively controlled.

Costs claimed by the contractor amounting to about $126,633 and $96,577 were disallowed and questioned, respectively. Further, the audit identified numerous weaknesses in Price Waterhouse Associates' system of internal controls which needed improvement. Lastly, the contractor needed to install a property management system for A.I.D.-financed commodities.

Contracts between Price Waterhouse Associates and the Government of Kenya specified that USAID/Kenya would reimburse Price Waterhouse Associates for costs that were allocable to the projects and incurred in accordance with the terms of the contracts. However, Price Waterhouse Associates claimed expenditures that were not reasonable or allocable to the A.I.D. projects. These erroneous claims were caused by weaknesses in Price Waterhouse Associate's internal accounting controls and by personnel turnover. As a result, Price Waterhouse Associates received excess reimbursement from USAID/Kenya of $126,633 and received additional reimbursement of $96,577 that should be reviewed for allowability by USAID/Kenya's contracting officer. This report recommends that USAID/Kenya's contracting officer recover disallowed expenditures and determine the allowability of questioned costs and amend the contracts to reflect audited overhead rates. The recommendation remains unresolved until planned specific implementing actions are outlined by management.

Contract provisions required that Price Waterhouse Associates maintain its accounting records in accordance with generally accepted accounting principles, and maintain an effective internal control system. Our audit disclosed several significant weaknesses in the contractor's system of internal controls. The weaknesses were due to nonenforcement of required operational procedures, and the lack of adequate supervision. As a result, contract funds totalling approximately $5.9 million were exposed to mismanagement. The report recommends that USAID/Kenya require Price Waterhouse Associates-Nairobi to maintain and adhere to established internal control procedures. The recommendation remains unresolved until specific planned actions to implement the recommendation are cited.

A.I.D. general contract provisions required the contractor to establish a property management system and to mark A.I.D.-financed commodities with the A.I.D. emblem. We noted that Price Waterhouse Associates had not established a property management system or marked A.I.D.-financed commodities with the required emblem. These deficiencies occurred because the contractor did not adhere to A.I.D. general contract provision requirements. As a result, A.I.D-financed commodities totalling about $70,000 could be lost or mismanaged. This report recommends that the contractor establish and maintain procedures for the management of non-expendable property for which the contractor has responsibility. The recommendation is unresolved until specific planned actions to implement the recommendation are outlined.

Office of the Inspector General

AUDIT OF
PRICE WATERHOUSE ASSOCIATES ACTIVITIES
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PRICE WATERHOUSE ASSOCIATES ACTIVITIES
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PART I - INTRODUCTION

A. Background

Price Waterhouse Associates (PWA) provided advisory, consulting, training and administrative services to the following three USAID/Kenya projects: (1) Commodity Import Program (2) Agricultural Management Project and (3) National Agricultural Research Project. PWA's involvement in the Commodity Import Program began in March 1985 and was to terminate in June 1989. This contract was signed between PWA Ltd. and USAID/Kenya. The contract objectives were to monitor the importation of program commodities into Kenya, ensure that commodities were properly utilized and that locally generated currency was deposited in accordance with program requirements. The contract to provide services to the Agricultural Management Project was signed between Price Waterhouse Associates and the Government of Kenya. in March 1987 and was to expire in September 1989. In this contract PWA was to provide advisory, consulting, training and administrative services to strengthen the management capacity and performance of Kenyan private and public organizations which support agricultural production especially among smallholders.

PWA also sub-contracted to provide services to the National Agriculture Research Project which began in July 1988 and is scheduled to end in June 1995. Price Waterhouse-Africa subcontracted with the curators of the University of Missouri to implement certain elements of the prime contract. This prime contract was signed on May 27, 1988 between MidAmerica International Agricultural Consortium and the Government of Kenya-KARI. Under this program PWA provided technical support to assist the Kenya Agricultural Research Institute with the design, testing, installation and on-the-job training in the use of critical management systems.

PWA agreed to provide properly qualified technical personnel who met minimum performance and qualification requirements. The Controller's Office and the Agriculture Office of USAID/Kenya were responsible for monitoring PWA financial activities and technical support.

A.I.D.'s budgeted commitment for PWA services totalled approximately $5.9 million. As of December 31, 1988 approximately $1.7 million had been expended (see details on exhibit 1).

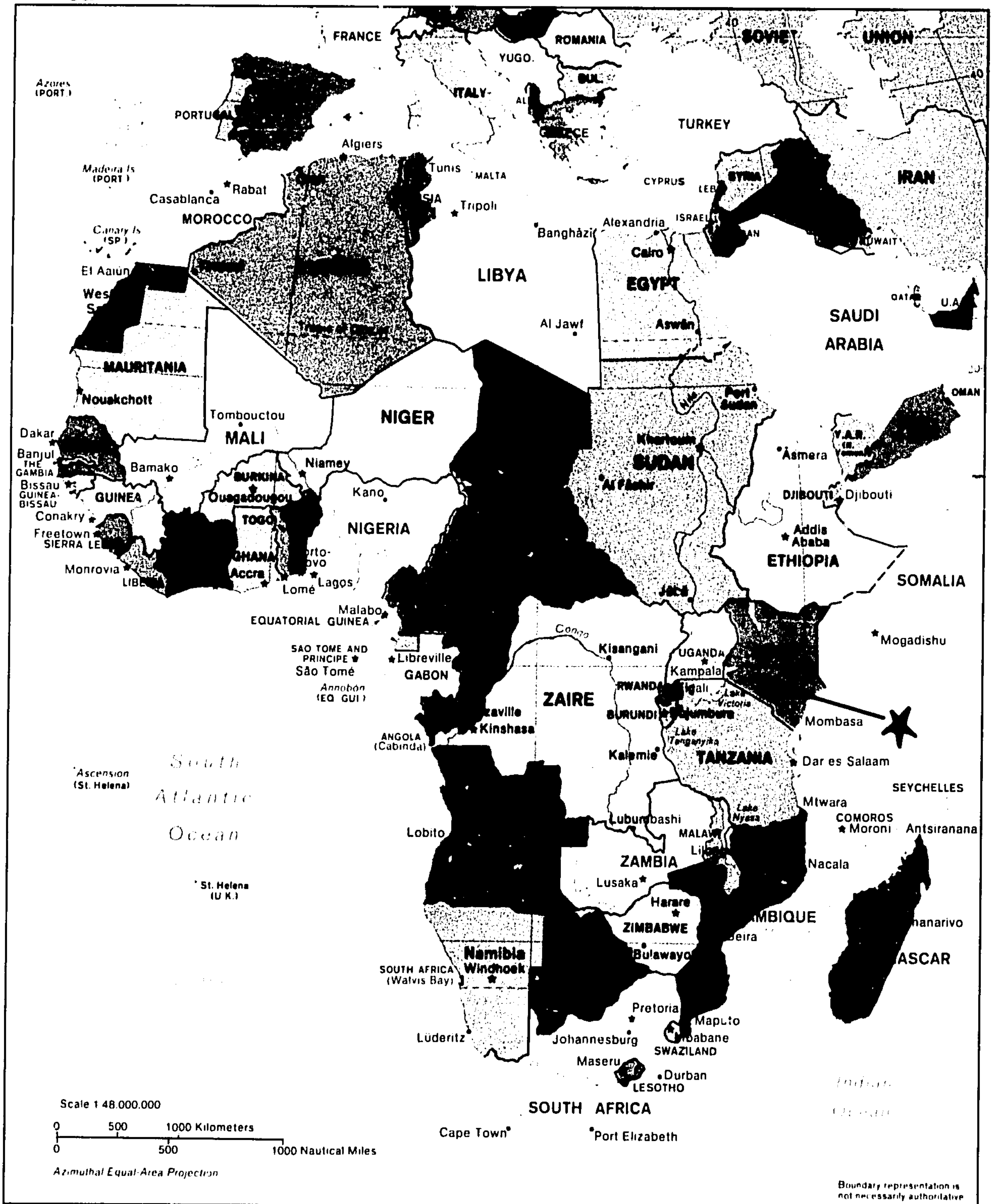
B. Audit Objectives and Scope

The Regional Inspector General for Audit, Nairobi made a financial audit of Price Waterhouse Associates expenditures relating to A.I.D.'s Commodity Import Program, the National Agriculture Research Project and the Agricultural Management Project. The specific audit objectives were to determine: (1) whether overhead rate computations for the three fiscal years ended June 30, 1988 were correctly computed and whether costs billed to USAID/Kenya were reasonable, allocable, allowable and in accordance with contract provisions, and (2) if PWA internal controls over project funds were adequate and effective, and (3) A.I.D.-financed commodities were effectively controlled.

The audit field work was performed from February through May 1989 and a record of audit findings was discussed with PWA officials on May 11, 1989. The audit covered expenditures of about $1.7 million (see exhibit 1 for details).

The audit included a review of PWA's project contracts, correspondence, selected accounting records and supporting documentation. Interviews were held with officials of PWA, USAID/Kenya and Egerton University, Kenya. However, the general ledger of PWA, Nairobi for the six months ended December 31, 1986, 79 invoices, and PWA financial statements for the fiscal years ended June 30, 1986, 1987 and 1988 were not available for our review. In addition, we did not audit any PWA revenue items and only reviewed personnel compensation expense for those PWA Nairobi employees working in the Management Consulting Department. These limitations prevented us from expressing an opinion on PWA, Nairobi internal control structure and from determining whether all costs charged to USAID/Kenya were reasonable, allocable and allowable. Subject to the limitations described above we reviewed PWA's internal control structure, and the weaknesses noted are identified in Finding No. 2 of this report. The audit was made in accordance with generally accepted Government Auditing Standards subject to the limitations described above.

Africa



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AUDIT OF
PRICE WATERHOUSE ASSOCIATES ACTIVITIES
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PART II - RESULTS OF AUDIT

Costs billed A.I.D. were reasonable, allocable and allowable; except that costs totalling $163,822 were over-billed due to the difference between overhead rates that should have been charged as determined by the audit and the provisional overhead rates that were actually charged. Further, other costs totalling $59,388 were disallowed or questioned due to the contractor's overstatement of daily salary rates, errors in billing and lack of supporting documentation. In addition, the contractor's system of internal control was inadequate in several respects, and A.I.D.-financed commodities were not being effectively controlled.

Costs claimed by the contractor amounting to about $126,633 and $96,577 were disallowed and questioned, respectively. Further, the audit identified numerous weaknesses in Price Waterhouse Associate's system of internal controls which needed improvement. Lastly, the contractor needed to install a property management system for A.I.D.-financed commodities.

The audit recommends (a) disallowance and questioned certain costs claimed by the contractor, and amendment of the three contracts to reflect the audited overhead rates; (b) improvement of the contractor's system of internal controls and (c) installation of an adequate and effective property management system.

A. Finding And Recommendations

1. Price Waterhouse Associates Billed A.I.D. For Costs Which Were Disallowed or Questioned

Contracts between PWA and the Government of Kenya (GOK) specified that USAID/Kenya would reimburse PWA for costs that were reasonable, allocable and allowable to the projects and incurred in accordance with the terms of the contracts. However, PWA claimed reimbursement for expenditures that were not reasonable, allowable or allocable to the A.I.D. projects. These costs arose by applying audited overhead rates instead of provisional and determination of amounts of personal telephone calls for recovery. These erroneous claims were caused by weaknesses in PWA's internal accounting controls and personnel turnover in PWA Nairobi's own accounting department. As a result, PWA received excess reimbursements from USAID/Kenya of $126,633 and received additional reimbursements of $96,577 which should be reviewed for allowability by the contracting officer.

Recommendation No. 1

We recommend that USAID/Kenya Contracting Officer:

a. disallow and recover $126,633 as detailed in Exhibit I;

b. determine the allowability of $96,577 of questioned costs as reflected in Exhibit I;

c. amend the overhead rate in the three contracts to reflect the actual audited overhead rates for the fiscal years ending June 30, 1986, 1987 and 1988 as appropriate; and use 1988's rate as the provisional rate for future fiscal periods;

d. together with the contractor, determine the amount of Agricultural Management Project funds expended for personal telephone calls and recover the amount from the contractor.

Discussion

The contract agreement between Price Waterhouse Associates and the Government of Kenya specified that the contractor should maintain, according to generally accepted accounting principles, books and records which accurately reflect the source and disposition of funds received and expenditures made under these contracts. In addition, Handbook 11 Chapter 4 and Federal Acquisition Regulation Part 31 covering contracts with commercial organizations outline the nature of allowable and unallowable costs and require costs to be reasonable, allocable and in accordance with specific contract provision requirements. Specific criteria and condition are discussed under each side caption as follows:

Overhead Rate Computations - A.I.D. Handbook 11 Chapter 4 stated that overhead rates in cost-reimbursement contracts are usually provisional until established as final (by audit or otherwise) at the completion of the contract. A provisional overhead rate is a temporary percentage factor that is mutually agreed upon by the contracting agency and the contractor. This factor is applied to an agreed upon base for use in making interim payments over a specified time period stated in the contract. Provisional rates are temporary pending the determination of the actual rate.

The provisional overhead rates compared to audited rates for Price waterhouse Associates were as follows:

	1985/86		1986/87		1987/88	
Detail	Provisional	Audited	Provisional	Audited	Provisional	Audited
CIP: Fringe Benefit Rate	47.00%	14.59%	47.00%	9.19%	47.00%	15.50%
Overhead Rate	68.00%	130.57%	68.00%	160.41%	68.00%	132.63%
AMP[1]/Field Rate[2]	-	-	171.97%	184.35%	171.97%	168.69%
Home Office Rate[2]/	-	-	182.70%	184.35%	182.70%	168.69%
KARI[1]/ Overhead Rate	-	-	-	-	180.00%	168.69%

1. AMP and KARI contracts did not have fringe benefit rates. Rather, the two contracts had overhead loading rates which were the compounding effect of the fringe benefit and overhead rates.

2. Contract amendment No. 1 dated April 1987 effectively changed the field rate and the home office rate to be the same.

As shown above the provisional overhead rates were different from the audited rates. The audit determined that PWA could not support the basis of the provisional overhead rates established in the three contracts. The overhead rate computation schedules contained numerous errors and our review determined the rates for the three fiscal years ended June 30, 1988 as shown in Exhibits 3, 4, 5 and 6.

Comparatively, the audited fringe benefit rate for fiscal year 1986/87 was lower than fiscal years 1985/86 and 1987/88 because Management Consulting Department personnel worked more on overhead pool time. Further, most of these personnel took less annual leave in fiscal year 1986/87. Conversely, the audited overhead rate for fiscal year 1986/87 was higher than other years because of PWA's high growth rate in fiscal year 1986/87.

PWA's overhead rate computations were not made in accordance with A.I.D. Regulations; expenditures used in PWA's computation were disallowed or questioned, overhead rate schedules contained errors, and supporting documentation could not be provided

As a result A.I.D. was over-billed by overhead costs totalling $68,557 which have been disallowed (see exhibit 2). If questioned costs were allowable in the computation of overhead rates, the rates would be as shown by footnotes in exhibits 4,5 and 6. These rates would result in allowing questioned overhead costs totalling $95,265 (see Exhibit 2).

Overstatement of Daily Salary Rates - Federal Acquisition Regulations Part 31 covering contracts with commercial organizations require that total compensation costs for personal services be reasonable for the services rendered or be commensurate with compensation paid under the contractor's established policy. In addition, A.I.D. Indefinite Quantity Contracts specified that the daily salary rate should be computed by dividing the individual's annual salary compensation by 260, the standard number of work days in a year. Further the CIP contract specified acceptable charges for PWA personnel with varying levels of training and experience.

Our review disclosed that the daily salary rate computed by PWA in the CIP and KARI projects did not agree with the computation specified in the contract because PWA did not compute the daily salary rate on 260 annual work days. PWA applied 220 work days to the CIP project and 215 days to the KARI project. Further, in CIP contract we noted that four personnel classified as "junior staff" were being billed to USAID/Kenya at "Senior Staff" rates. Thus the daily salary rates for the CIP and KARI contracts were both overstated which resulted in overcharges to USAID/Kenya of $19,764 for CIP and $12,312 for KARI (see exhibit 2).

Errors In Billings - General contract provisions require the contractor to certify that documentation for payment was prepared from the books and records of the contractor in accordance with the terms of the contract, and that the documents are correct and the sum claimed is proper and due.

We noted that arithmetic errors existed in PWA's KARI and AMP billings to A.I.D.. The AMP contract was overcharged $15,996 due to the duplication of per diem allowances and the inclusion of unallowable miscellaneous expenses. The KARI billing errors did not result in an over reimbursement by A.I.D. but did erroneously reflect a $20,792 undercharge in the cumulative amount invoiced to A.I.D.

As a result A.I.D. reimbursed PWA $15,996 in excess of allowable amounts.

<u>Lack of Supporting Documentation</u> - The CIP contract specified that documentation supporting and approving travel and per diem charges be submitted with PWA's request for reimbursement. During our audit we noted that $1,049 of travel and $263 of per diem charges were not supported by adequate documentation and/or properly authorized.

As a result, travel and per diem charges totalling $1,312 have been questioned for the contracting officers determination.

<u>Excessive Time Billed USAID/Kenya</u> - Federal Acquisition Regulations Part 31-201-4 states that a cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship.

We examined time sheets of various employees and noted that USAID/Kenya was charged for time not worked. For example, an employee's time sheets for the period May 1985 through December 1988 charged 4,133 hours to the CIP project. The work-in-progress report used for billing purposes reflected a total of 4,146 hours for this employee. Thus, USAID/Kenya was overcharged for 13 hours which totalled $102 (Kshs.1,718). In addition, USAID/Kenya was charged $101 (kshs. 1,692) under the AMP contract for 7 1/2 hours of an employee's time when the employee was actually on leave. In addition, four employees overcharged AMP contract for time not worked and using incorrect monthly rates. This resulted in USAID/Kenya being over-billed by $9,903.

The above instances show that USAID/Kenya was charged for hours not actually worked and using incorrect monthly rates. As a result, we have disallowed the $10,004 for AMP contract and $102 for the CIP contract excessive charge (see Exhibit 2).

<u>Personal Telephone Calls</u> - Federal Acquisition Regulations Part 31-201-4 state that a cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship.

Further, the cost is allocable if it is incurred specifically for the contract; benefits both the contract and other work, and can be distributed to them in reasonable proportion to benefit received, or is necessary for the overall operation of the business.

The audit disclosed that PWA personnel involved in the AMP project at Egerton University made personal telephone calls, the costs of which were charged to USAID/Kenya. However, because of incomplete documentary evidence, we were unable to determine the dollar amount involved. Thus, USAID/Kenya, in conjunction with PWA, should determine the dollar amount of personal calls and disallow these charges.

PWA invoiced USAID/Kenya for costs which were disallowed or questioned because of weaknesses in the contractor's system of internal controls. Numerous deficiencies existed including recording of transactions, lack of support for provisional overhead rates reflected in the contracts, numerous errors on records and schedules, and inadequate supervision of contractor staff. Further, a ledger and 79 vouchers selected for review were missing.

PWA officials acknowledged that three years ago the system had numerous deficiencies, but improvements had been made. For example, the contractor changed from a manual to a computer system and weaknesses identified were being corrected. PWA officials attributed the deficiencies noted during our audit to high turnover in the accounts department, including the financial controller's position.

As a result of these deficiencies, A.I.D. was billed for disallowed and questioned costs amounting to $126,633 and $96,577 respectively (see Exhibit 2).

In conclusion, the contractor should be required to reimburse the U.S. Government disallowed costs totalling $126,633, the contracting officer should determine the allowability of questioned costs amounting to $96,577, the three contracts should be amended to reflect the audited overhead rates, and the amount of personal calls should be determined and recovered.

Management Comments

USAID/Kenya stated it had no objection to Recommendation No. 1. Although Price Waterhouse Associates did not specifically address the recommendation, its comments (Appendix 1) presented several significant areas of disagreement.

First, the contractor stated that labor costs for its project manager on the AMP contract were paid by its Washington D.C. office. The contractor stated, further, that his salary, therefore, should not have been included in the direct labor base in calculating the audited overhead rate. According to the contractor, this factor inappropriately understated the audited overhead rate by about 30 percent for fiscal year 1988.

Second, the contractor stated that this report applied audit results to a period not covered by the audit. The contractor stated that the overhead rate as audited for the period ending June 30, 1988 should not have been used for an additional six-month period ending December 31, 1988, as the actual overhead rate may change for the next fiscal period.

Third, the contractor stated that the audit's disallowance of certain costs for fiscal year 1986/87 was inappropriate. (Certain indirect costs for this year were disproportionately high as compared with other fiscal years, and were therefore questioned). The contractor stated that cost principles of the Federal Acquisition Regulation required that costs be allowed unless they could be specifically determined to be unallowable.

Office Of Inspector General Comments

The contractor's comments were carefully considered and certain suggested changes were incorporated in the final report. The following responds to the specific points raised by the contractor.

Concerning the project manager's salary, both the contracting officer and an A.I.D. legal advisor concluded that the manager's salary should be included in the direct labor base in computing the overhead rate, as we have done. This was because the manager's compensation was specifically included in the contract budget. Therefore, we continue to question the allowability of these costs (Exhibits 5 and 6).

Concerning the second issue, we continue to believe it was appropriate to extend use of the overhead rate as computed for the year ending June 30, 1988 to the additional six-month period ending December 1988. We believe that audited overhead rate is more accurate for costing A.I.D. contracts than the provisional contract overhead rate. Accordingly, we have questioned these costs (Exhibit 6).

Concerning the third point, the expenses for FY 1986/87 for printing, office salaries, miscellaneous costs, motor vehicle use and postage were very high compared to the prior and subsequent fiscal years. Therefore, we questioned the allowability of a portion of these expenses, pending the contracting officer's determination as to their allowability (Exhibit 5).

The Office of Inspector General considers Recommendation No. 1 unresolved until the USAID/Kenya, in coordination with the contractor, outlines specific actions planned to implement the recommendation. The recommendation will be closed upon the provision of evidence that corrective actions have been fully implemented.

2. The Internal Control Structure of Price Waterhouse Associates Needed Improvement

Contract provisions required Price Waterhouse Associates to maintain its accounting records in accordance with generally accepted accounting principles and to maintain an adequate and effective internal control system. Our audit disclosed several significant weaknesses in the contractor's system of internal controls. The weaknesses were due to non enforcement of required operational procedures, and the lack of adequate supervision. As a result, contract funds totalling approximately $5.9 million were subject to mismanagement.

Recommendation No. 2

We recommend that the Director, USAID/Kenya require Price Waterhouse Associates to:

a. maintain and adhere to established internal control procedures relating to petty cash, time-keeping, bookkeeping, filing, and cancellation of paid invoices/vouchers, and

b. establish, implement and maintain adequate and effective internal control procedures for recording transactions, preparing ledgers and trial balances.

Discussion

The contracts required Price Waterhouse Associates to maintain books and records which accurately reflected the source of funds received and the disposition of expenditures made in accordance with generally accepted accounting principles. Generally accepted accounting principles require the maintenance of an adequate internal control structure. This internal control structure consists of the policies and procedures established to provide reasonable assurance that specific entity objectives will be achieved. The internal control structure consists of three elements, namely: control environment, accounting system and control procedures.

Our review disclosed several significant problems with PWA's internal control structure. Serious problems were noted with petty cash, time-keeping for billing purposes, filing, cancellation of paid invoices/vouchers, bookkeeping, and preparation of ledgers and trial balances. These items are discussed under the appropriate captions as follows:

Petty Cash - We reviewed the petty cash procedures for AMP at Egerton University and noted several weaknesses. To ensure accountability and improve control, petty cash vouchers should have been pre-numbered. We observed during our review that these vouchers were not pre-numbered, thus weakening control of petty cash funds. We noted an unapproved petty cash travel expenditure of Kshs.2,000 and a payment for Shs.300/= of which acknowledgment of receipt was not provided. We also learned that cash advances remained outstanding for unreasonably long periods without being cleared. For example, we noted 12 cash advances made between October 1987 and September 1988 totalling $247 (Kshs.4,140) which had not been accounted for as of March 1989. In addition, there was no evidence of any effort to recover these funds.

It also came to our attention that surprise petty cash counts were never conducted, that the fund often exceeded its float limit of Kshs.5,000 and that voucher transactions were not recorded on a timely basis.

The weaknesses associated with the petty cash fund arose because PWA did not adhere to its written operating procedures.

Time Keeping System For Billing Purposes - Our review of PWA's time keeping system showed that this system was vulnerable to manipulation by individual personnel and it was unable to detect errors. We noted that individual time sheets were processed without prior approval by appropriate managers and that nine time sheets were prepared in pencil instead of ink. As discussed in Audit Finding No. 1 PWA over charged USAID/Kenya for 20 1/2 hours of staff time.

These problems arose because PWA management did not monitor personnel time on a daily basis and did not properly review and approve individuals timesheets.

Contractor Filing System - Both PWA and our own audit staff experienced a great deal of difficulty in finding supporting documents and tracing accounting entries through their records. The PWA Nairobi general ledger for the six months ended December 31, 1986 and 79 vouchers supporting expenditures for fiscal years 1985 through 1987/88 could not be supplied by PWA.

PWA's failure to follow adequate and effective control procedures and the frequent personnel turnover in its accounting department were major reason for these filing problems.

Bookkeeping - Various deficiencies were noted in the contractors recording of transactions. In June 1988 entertainment expenses totalling $6,534 (Kshs. 109,636) were erroneously included in the motor vehicle and travel expense accounts.

Errors were also noted in PWA's overhead rate computation and supporting schedules. An employee's actual compensation of Kshs. 174,000 was erroneously reflected on an overhead rate schedule as Kshs.1,274,000. In addition, time sheet and labor analysis schedules contained many errors and were revised by PWA during our field work process.

Material adjustments were made at the end of each fiscal year by using informal work sheets. However, the respective journal entries were not posted to the general ledger. Further, it was difficult to trace these journal vouchers to their respective supporting documents. In addition, we noted that some of their work sheets were not approved by a responsible PWA official.

Transactions were recorded irregularly because of weaknesses in PWA's internal control structure. Overhead rate computation schedules provided for audit contained numerous obvious errors, and journal voucher entries were not recorded in the general ledger. We also noted that "Junior Staff" personnel were not properly supervised.

<u>Ledger and Trial Balance Preparation</u> - Discrepancies were noted between general ledger balances and corresponding trial balances. These balances did not agree because appropriate journal voucher entries were not recorded in the ledger. In addition, when reviewing the PWA Mombasa ledger for fiscal year 1987/88, we noted that it was prepared in pencil instead of ink; thus being vulnerable to manipulation.

Many segmented trial balances were prepared by the PWA Nairobi branch for the fiscal year ended June 30, 1988. To derive the final balances at June 30, 1988, three trial balances covering different periods had to be combined. The process involved the following:

- to derive the balances for 12 months ended June 30, 1988, we added trial balance figures for six months ended June 30, 1988 to balances for the six months ended December 31, 1987.

- to derive the balance for the six months ended December 31, 1987 we subtracted trial balances for twelve months ended December 31, 1987 from twelve months ended June 30, 1987; and added these balances to the trial balance figures for the six months ended December 31, 1986.

Although correct, this process of calculation wasted a lot of valuable audit time. Nevertheless, we could not verify the trial balance for the six months ended December 31, 1986 because the relevant ledger was missing.

These conditions occurred because the contractor did not maintain an adequate and effective internal control system. Further, PWA "Junior staff" were not properly supervised to ensure effective maintenance of internal controls. Discussions with PWA officials disclosed that these weaknesses were attributed to the high personnel turnover rate within their accounting department.

Cancellation of Paid Invoices/Vouchers - We selected 307 vouchers/invoices for detailed testing and noted that 93 invoices/vouchers were not marked "paid" after payment. This weakness could allow invoices/vouchers already paid but not marked or stamped "paid" to be processed and paid again.

This situation existed because "Junior staff" were not properly supervised and the staff did not follow established procedures.

Overall, our review concluded that PWA's internal control structure relating to petty cash, time-keeping for billing purposes, filing, cancellation of paid invoices/vouchers, book-keeping, and preparation of ledgers and trial balances had weaknesses as identified in the report (see Exhibit 8). Since this was a segmented audit, the audit risk and materiality level of mistatement of financial statements could not be covered. However, the limitations cited in this finding prevented us from expressing an opinion on PWA, Nairobi internal control structure and from determining whether all costs charged to USAID/Kenya were reasonable, allocable and allowable. The weaknesses in the contractor's system of internal controls and the accounting errors noted, were subjecting contract funds totalling $5.9 million to mismanagement.

In conclusion, Price Waterhouse Associates should be required to maintain procedures already established and to establish and implement needed internal control procedures.

Management Comments

USAID/Kenya agreed with Recommendation No. 2, stating that it noted with concern existence of deficiencies in the contractor's system of internal control. Further, the mission stated that these deficiences have to be rectified to ensure that the contracts' provisions are complied with and that A.I.D. is assured of receiving the original contracts' intended services.

The contractor's response did not specifically address the recommendation, but objected to use of what it stated was inaccurate and inflammatory language.

Neither USAID/Kenya nor the contractor indicated specific actions planned to implement Recommendation No. 2.

Office Of Inspector General Comments

The report was changed to incorporate some changes suggested by the contractor.

The Office of Inspector General considers Recommendation No. 2 unresolved until the mission, in conjunction with the contractor, cite specific actions planned to implement the recommendation. The recommendation will be closed upon providing documentary evidence that corrective actions have been implemented.

3. Price Waterhouse Associates Needed to establish a Property Management System

A.I.D. general contract provisions required the contractor to establish a property management system and to mark A.I.D. financed commodities with the A.I.D. emblem. We noted that PWA had not established a property management system or marked A.I.D. financed commodities with the required emblem. These deficiencies occurred because the contractor did not adhere to A.I.D. general contract provision requirements. As a result, A.I.D. financed commodities totalling approximately $70,000 could be lost or mismanaged.

Recommendation No. 3

We recommend that the Director, USAID/Kenya require Price Waterhouse Associates to:

a. establish and maintain procedures (approved by the Mission) for the receipt, use, maintenance, protection, custody and care of non-expendable property for which the contractor has custodial responsibility;

b. mark A.I.D. financed commodities with the A.I.D. red, white and blue handclasp emblem.

Discussion

A.I.D. general contract provisions required the contractor to establish and maintain a program, approved by the Mission, for the receipt, use, maintenance, protection, custody and care of non-expendable property for which it has custodial responsibility, including the establishment of reasonable controls to enforce such program. Further, A.I.D. policy requires that A.I.D. financed commodities be marked with the A.I.D. emblem. The Commodity Import Program contract incorporated this provision by reference.

Price Waterhouse Associates had not established or maintained a property management system. The audit disclosed various weaknesses associated with PWA's failure to implement and maintain a property management system. We noted there was no signed receipt document or record in the contractor's files of IBM computer equipment valued at approximately $5,000. Contractor officials believed that this equipment was delivered from USAID/Kenya in 1985 for use in the Commodity Import Program. In addition, we were unable to find any documents at the Mission to substantiate the procurement of this equipment. Physical verification of the equipment disclosed that it was an IBM computer PC/XT model 5160 Serial No. AQ550026754 together with an IBM color monitor screen model 5153 Serial No. 0786912 and a keyboard. The equipment was not marked with the required A.I.D. red, white and blue handclasp emblem.

Agriculture Management Project funds were used to purchase two Peugeot Saloons, one Peugeot Estate, and one Landrover. The three peugeot vehicles were assigned to the contractor for official Agriculture Management project use. However, in September 1988, USAID/Kenya loaned the 4-wheel drive Landrover, purchased in May 1988 and valued at approximately $6,000, to Egerton University for a limited period of three months. In March 1989, seven months later, the Landrover was still being used by the University for non project related activities. Discussions with PWA, University and project officials disclosed that there was no indication as to when the University would return the Landrover for official project usage.

Our review of vehicle utilization records disclosed that log sheets did not indicate the purpose of the trip, the name and signature of the official using the vehicles and whether the vehicle was used for official purposes. In addition, PWA officials disclosed that contract team members were using project vehicles for personal transportation purposes. However, we were unable to quantify the extent of such non official use.

Physical observation of project funded commodities at Egerton University disclosed that non-expendable property such as vehicles, computer equipment, photocopier, and typewriters did not bear the required A.I.D. red, white and blue handclasp emblem. In addition, a responsible University official stated that it was the University's practice not to label or identify such donated equipment.

These conditions existed because PWA did not adhere to general contract provision requirements and the USAID/Kenya Mission did not adequately enforce the relevant contract provisions requiring establishment of a property management system and the labeling of A.I.D. financed commodities.

As a result of these deficiencies, A.I.D. financed commodities totalling approximately $70,000 could be lost and mismanaged.

In conclusion, the contractor should establish and maintain a property management system in accordance with A.I.D. general contract provision requirements and should ensure all A.I.D. financed commodities are labeled with the appropriate handclasp emblem.

Management Comments

USAID/Kenya agreed with Recommendation No. 3 and stated that the cited problems have to be rectified to ensure compliance with contract provisions. Further, concerning use of the vehicle, USAID/Kenya stated the Vice-Chancellor of Egerton University has clarified the University's policy on vehicle use to agree with A.I.D.'s requirements.

The contractor's response did not specifically address the recommendation or suggest any changes.

Office of Inspector General Comments

Although USAID/Kenya agreed with the recommendation, neither it nor the contractor proposed specific actions to implement it. The Office of Inspector General, therefore, considers Recommendation No. 3 unresolved until the mission, in coordination with the contractor, outlines and completes specific actions to implement the recommendation.

B. Compliance and Internal Control

Compliance

Finding No. 3 discussed PWA's noncompliance with the contracts' provisions requiring the establishment and maintenance of a property management system.

In addition the general ledger for the six months ending December 31, 1986, and 79 vouchers were missing and thus could not be reviewed. PWA's financial statements were not made available for our review and we were able to examine only excerpts of portions of overhead expenditures. Thus we could not determine whether the missing items were in compliance with applicable regulations and contract terms. However, nothing came to the auditors' attention that caused the auditors to believe the untested items were not in compliance with applicable laws and regulations.

Internal Control

Finding Nos. 1 and 2 discussed the internal control weaknesses noted during our review.

AUDIT OF
PRICE WATERHOUSE ASSOCIATES ACTIVITIES
IN KENYA UNDER THREE A.I.D. CONTRACTS

PART III - EXHIBITS AND APPENDICES

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Summary Schedule Of Three Contracts Cumulative Billings
From Inception Through December 31, 1988
Total Cost Billed, Accepted, Disallowed And/Or Questioned

Description	Total Cumulative Expenditure $	Accepted $	Disallowed $	Questioned $	Notes
AMP	1,043,551	952,812	52,793	37,946	a/
KARI	290,432	246,838	20,143	23,451	b/
CIP	318,906	230,029	53,697	35,180	c/
TOTAL $	1,652,889	1,429,679	126,633	96,577	d/
Percentages	100%	86%	8%	6%	

Notes

a - see Exhibit 1 page 2 of 5 for details
b - see Exhibit 1 page 4 of 5 for details
c - see Exhibit 1 page 5 of 5 for details
d - see Exhibit 2 for details

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Schedule of Price Waterhouse Associates, Nairobi
AMP Contract Cumulative
From Inception to December 31 1988

Total Costs Billed, Accepted, Disallowed and/or Questioned
(In U.S. Dollars)

	Total Cumulative Billings	Accepted	Disallowed	Questioned	Note
AMP Billings					
Field Staff	231,718	225,477	6,241	-	(c)
Field Staff Differential	15,860	15,860	-	-	
Overhead on Field Staff	371,639	357,456	(11,084)	25,267	(a)
Home Office Salaries	27,214	23,451	3,763	-	(c)
Overhead Home Office	49,574	40,071	(277)	9,780	(b)
Fixed Fee	110,183	69,130	38,154	2,899	(f)
Subcontract Costs	17,795	17,795	-	-	
Cost of Consultants	52,972	52,972	-	-	
Travel Per Diem					
(a) International	34,296	34,296	-	-	
(b) Kenya	36,553	24,767	11,786	-	(d)
Personal/Baggage/Transport	18,460	18,460	-	-	
Equipment Transport	1,517	1,517	-	-	
Equipment	29,615	29,615	-	-	
Other Direct Costs					
Insurance	11,803	11,803	-	-	
Miscellaneous	34,183	29,973	4,210	-	(e)
Housing	169	169	-	-	
Training Costs	-	-	-	-	
Total	$1,043,551	952,812	52,793	37,946	

Notes:

(a) AMP Overhead associated with field staff salaries was overstated by $14,183. This consisted of $25,267 which represented questioned costs which would arise if questioned costs were disregarded when computing overhead rates and a negative $11,084 of disallowed costs. Of $25,267 questioned, $508 relate to overhead costs for the period July through December 1988.

(b) AMP Overhead associated with home office salaries was overstated by $9,503. This consisted of questioned costs of $9,780 which would arise if questioned costs were disregarded when computing overhead rates and a negative $277 of disallowed costs. Questioned costs of $9,780 include $842 relating to overhead costs for the period July through December 1988.

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(c) AMP home office salaries and field staff salaries were overstated by $3,763 and $6,241 respectively. These overstatements were the result of using monthly charge rates on employees which was higher than the audited charge rates.

(d) The per diem travel allowance of AMP was overstated by $11,786 due to the following per diem duplications:

Peter Cody's per diems - Memo dated October 21, 1988	$10,649
Felix Karingi per diems - Claim dated September 13, 1988	$ 490
Peter Cody's per diems - excess billing per Invoice No. 4	$ 647
	$11,786

(e) AMP miscellaneous expenses were overstated by $4,210

- Invoice No. 1 contained $1,258 of duplicated expenditures

- Telephone, Telex and Fax charges per invoice No. 11 should have been $36.51 instead of $1,341, an overstatement of $1,304.

- advertising costs of $1,648 were not allowable.

(f) The fixed fee was payable incrementally in the same ratio to the total fixed fee as the incremental payment of allowable costs was to the total estimated costs.

Schedule of Price Waterhouse Associates, Nairobi
KARI Contract Cumulative
From Inception to December 31 1988

Total Costs Billed, Accepted, Disallowed and/or Questioned
(In U.S. Dollars)

	Total Cumulative Billings	Accepted	Disallowed	Questioned	Note
KARI Billings In $					
Disbursements	1,500	1,500	-		
Salaries	72,933	64,847	8,086	-	(a)
Overhead on Salaries	132,008	112,356	5,122	14,530	(b)
Fixed Fee	11,525	10,632	21	872	(b)
Sub-total	$ 217,966	189,335	13,229	15,402	
KARI Billings in Kenya Shillings					
Salaries	409,696	338,787	70,909	-	
Overhead on Salaries	741,542	571,500	40,325	129,717	
Fixed Fee	64,740	54,617	4,777	5,346	
Sub-total	Kshs.1,215,978	964,904	116,011	135,063	
Converted to $ at Kshs.16.78	$ 72,466	57,503	6,914	8,049	(c)
$	290,432	246,838	20,143	23,451	

(a) KARI salaries were overstated by $8,086 because 215 base days per year were used in the calculation instead of the appropriate 260 standard days per year.

(b) KARI overhead salaries included disallowable costs of $5,122 and questioned costs of $14,530. This was the net effect of the difference between the provisional overhead rate of 180% and the audited rates applied on the salaries and the difference mentioned in (a) above. Consequently fixed fee of $21 and $872 was disallowed and questioned respectively. Of questioned costs amounting to $15,402, overhead costs of $4,631 relate to the period from July through December 1988.

(c) KARI administrative salaries, overhead costs and PWA's fixed fee were overstated by disallowed costs of $6,914 (Kshs.116,011) and questioned costs of $8,049 (Kshs.135,063). This was caused by using 215 base days per year instead of the accepted standard 260 days per year, and using the provisional overhead rate instead of the audited overhead rate. Questioned costs of $8,049 include $2,421 relating to overhead for the period from July to December 1988.

Schedule of Price Waterhouse Associates, Nairobi
CIP Contract Cumulative
From Inception to December 31 1988

Total Costs Billed, Accepted, Disallowed and/or Questioned

	Total Cumulative Billings	Accepted	Disallowed	Questioned	Note
CIP Billings in Kenya Shillings					
Salaries	1,553,383	1,221,739	331,644	-	(a)
Fringe Benefit	730,088	171,653	470,785	87,650	(b)
Overhead	2,364,380	1,920,636	18,361	425,383	(c)
Transport & Travel	102,632	85,024	-	17,608	(d)
Allowance/Per Diem	21,829	17,423	-	4,406	(e)
Other Direct Costs	93,128	93,128	-	-	
Fixed Fee	485,797	350,280	80,239	55,278	(f)
Sub-total Kshs.	5,351,237	3,859,883	901,029	590,325	
Converted to $ @ Kshs.16.78	$318,906	230,029	53,697	35,180	

(a) Charges for CIP salaries were overstated by $19,764 (Kshs 331,644) due to the application to annual salary costs of 220 base days per year instead of 260 days per year. This overcharge also occurred because PWA charged lesser qualified "Junior staff" personnel hour at higher "Senior staff" rates.

(b) Charges for CIP fringe benefits were overstated by disallowed costs of $28,056 (Kshs470,785) and questioned costs of $5,223 (Kshs87,650) because the provisional fringe benefit rates were higher than the audited fringe benefit rates. Questioned costs of $5,223 included $4,537 relating to the period July through December 1988.

(c) CIP overhead charges were overstated by disallowed costs of $1,094 (Kshs18,361) and questioned costs of $25,351 (Kshs.425,383). This was the result of applying the difference between provisional overhead rates and audited overhead rates to the overcharges in (a) and (b) above. Questioned costs of $25,351 include $2,603 relating to the period July to December 1988.

(d) CIP transportation and travel costs totaling $1,049 (Kshs.17,608) were questioned because of inadequate authorizations and supporting documentation.

(e) Supporting documentation was not available for CIP per diem and travel allowances totaling $263 (Kshs.4,406).

(f) CIP fixed fee was overstated by disallowed costs of $4,783 (Kshs.80,239) and questioned costs of $3,294 (Kshs.55,278). This was because of computing fixed fee on costs disallowed and questioned as indicated in a, b. c, d and e above. Of the questioned costs of $3,294, costs relating to the period July to December 1988 amount to $902.

EXHIBIT 2

Schedule Of Price Waterhouse Associates, Nairobi Disallowed And Questioned Costs For The Period From Inception Through December 31, 1988 (In U.S. Dollars)

CONTRACT	CIP	AMP	KARI	TOTAL
Disallowed Costs				
Overhead Rate Computation	$33,933	$26,793	$ 7,831	$ 68,557
Daily Salary Rate	19,764a/	10,004	12,312	42,080
Errors in Billings	-	15,996	-	15,996
	$53,697	$52,793	$20,143	$126,633
Questioned Costs				
Lack of supporting Documentation	$1,312	-	-	$1,312
Overhead Rate Computation	33,868	37,946	23,451	95,265
	$35,180	$37,946	$23,451	$96,577

Notes

a/ - Combined effect of using 220 days instead of 260 days as the base standard days in one year and charging junior staff time at senior staff rates. Further, This includes $102 being excessive time billed A.I.D. for 13 hours not worked.

Audited Schedule of Price Waterhouse Associates, Nairobi
Multiplier: Compound Overhead Rate Computation
For The Period July 1985 To June 30, 1988
(In Kshs)

	1985/86	1986/87	1987/88
Direct Expenses			
Direct Labor Costs	3,146,676	5,148,679	7,680,866
Indirect Expenses			
Overhead Labor Costs	2,269,715	4,568,586	5,290,189
Fringe Labor Costs	834,316	893,371	2,010,870
Partners Administration Costs	275,062	393,671	552,778
Overhead Expenses	2,025,498	3,167,650	4,417,152
Head Office Allocation (Worldwide)	255,557	468,357	686,027
Total Indirect Expenses	5,660,148	9,491,635	12,957,016
% of Indirect to Direct Expenses	164.22%	184.35%	168.69%*

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* The above adjusted and audited rates are the compound loading rates which include both the fringe rate and overhead rate.

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Schedule Of Price Waterhouse, Nairobi
Fringe Rate And Overhead Rate Computation
For The Periods July 1 1985 TO JUNE 30 1988
(In Kshs)

		Fiscal Year July 1 to June 30		
		1985/86	1986/87	1987/88
Fringe Rate Computation				
Total Fringe Labor Cost of Charging Staff	(a)	834,316	893,371	2,010,870
Overhead Labor Plus Direct Labor Costs	(b)	5,716,391	9,717,265	12,971,055
Fringe Rate	(a)/(b)	14.59%	9.19%	15.50%
Overhead Rate Computation				
Overhead Labor Costs		2,269,715	4,568,586	5,290,189
Fringe on Overhead Labor at above Fringe Rate		331,151	419,853	819,979
Partners Administration Costs		275,062	393,671	552,778
Overhead Expenses		2,025,498	3,167,650	4,417,152
Head Office Allocation (Worldwide)		255,557	468,357	686,027
Total Overhead Pool	(c)	5,156,983	9,018,117	11,766,125
Direct Labor Costs		3,446,676	5,148,679	7,680,866
Fringe on Direct Labor at above Fringe Rate		502,870	473,163	1,190,534
Total Direct Labor Plus Fringe	(d)	3,949,546	5,621,842	8,871,400
Overhead Rate	(c)/(d)	130.57%	160.41%	132.63%

Multiplier: Compound Loading Rate (Fringe + Overhead)
(Assume direct labor to be Kshs.1.00)

	1985/86	1986/87	1987/88
Direct Labor	1.0000	1.0000	1.000
Add: Fringe at above rate	0.1459	0.0919	0.155
Sub-total	1.1459	1.0919	1.155
Add: Overhead x (Direct + Fringe) at above rate	1.4963	1.7516	1.5319
Total=Direct+Fringe+Overhead	2.6422	2.8435	2.6869
Less:Direct Labor Element	1.0000	1.0000	1.0000
Gross (Fringe + Overhead)	1.6422	1.8435	1.6869
Compound Loading Rate (Fringe + Overhead)	164.22%	184.35%	168.69%

This schedule proves the calculation of the overhead loading rate shown on Page 1 of this exhibit. These percentages are adjusted audited rates.

Schedule of Price Waterhouse Associates, Nairobi
Overhead Rate Computation Period
12 Months To June 30TH 1986
(In KSHS)

	PWA-Nairobi O/H Schedule	Audited and Accepted	Disallowed	Questioned	Note*
Direct Expenses:	Kshs.	Kshs.	Kshs.	Kshs.	
Direct Labor costs	3,059,083	3,446,676	(387,593)	-	(a)
Indirect Expenses:					
Overhead Labor	2,137,321	2,269,715	(132,394)	-	(b)
Fringe Labor costs	732,317	834,316	(101,999)	-	(c)
Partners Administration costs	387,936	275,062	112,874	-	(d)
Overhead expenses	2,502,305	2,025,518	277,582	199,205	(e)
Head office allocation (Worldwide)	255,557	255,557	-	-	
Total Indirect expenses	6,015,436	5,660,168	156,063	199,205	
Percentage of Indirect to Direct Expenses	196.64%	164.22%			

Note: If the questioned costs were disregarded the audited overhead rate would be 170%.

NOTES - Disallowed Costs

(a) Direct Labor Costs 1985/86

Direct labor costs were understated by Kshs.387,593 because of corrections to a labor cost analysis schedule which erroneously reflected an employee's total compensation as Kshs.68,000 instead of Kshs.680,000.

(b) Overhead Labor Costs 1985/86

Overhead labor costs per the PWA Nairobi overhead rate computation were understated by Kshs.132,394 because of the reason given in (A) above.

(c) Fringe Labor Costs 1985/86

Fringe labor costs per the PWA Nairobi overhead rate computation were understated by Kshs.101,999 because of the reason given in (A) above.

(d) Partners Administration Costs 1985/86

Partners Administration costs per the PWA Nairobi overhead rate computation were overstated by Kshs 112,874 because FS-I rates were erroneously divided by 1950 hours instead of being divided by the total hours worked by each respective partner.

(e) Overhead Expenses 1985/86 - (Management Consulting Portion)

1. Disallowed Costs

Kshs.277,582 - Business meals and practice development costs included various entertainment expenditures such as Golf Day Sponsorship, restaurant bills and the cost of mailing the "Kenya Business Guide". In addition, these costs included miscellaneous expenses such as membership subscriptions to the Mount Kenya Safari Club, donations to St. Johns in Kenya, gifts and a Kshs 39,279 gain on the sale of fixed assets.

2. Questioned Costs

Of the sample of expenditures selected for our review, supporting vouchers and documentation could not be provided for expenditures totaling Ksh 199,205. These unsupported expenditures included the following:

	Kshs
Indemnity and insurance	4,503
Printing and stationery	77,549
Motor vehicle and travel	81,947
Business meals and per diem	14,394
Miscellaneous expenses	20,812
Total	199,205

Schedule Of Price Waterhouse Associates, Nairobi
Overhead Rate Computation-Period
12 Months Ended June 30, 1987
(In Kshs)

	PWA-Nairobi O/H Schedule Kshs.	Audited and Accepted Kshs.	Disallowed Kshs.	Questioned Kshs.	Note
Direct Expenses:					
Direct Labor Costs	5,979,873	5,148,679	998,082	(166,888)	(f)
Indirect Expenses:					
Overhead Labor Costs	4,812,955	4,568,586	244,369	-	(g)
Fringe Labor costs	840,837	893,371	(52,534)	-	(h)
Partners Administration Costs	840,971	393,671	201,544	245,756	(i)
Overhead expenses	5,032,075	3,167,650	364,915	1,499,510	(j)
Head office allocation (Worldwide)	813,202	468,357	344,845	-	(k)
Total Indirect expenses	12,340,040	9,491,635	1,103,139	1,745,266	
% of Indirect to Direct Expenses	206.36%	184.35%			

Note: If the questioned costs were disregarded (including Peter Cody's costs) the audited overhead rate would be 225.60%. For notes (F) through (K) see Exhibit 5 pages 3 and 4.

PWA Nairobi

Overhead Expenditures - Unreasonable Expenditures - 1986/87

Comment:

Some expenditures in fiscal year 1986/87 were overstated and appeared to be unreasonably large. In our opinion, these expenditures should be reduced using the following formula:

> The proportionate expenditure increase in fiscal year 1986/87 should be limited to the proportion increase in indirect labor costs from fiscal years 1985/86 to 1986/87.

Calculation of Allocation Base Rate

	1985/86	1986/87	Difference	Percentage Increase
	KShs.	KShs.	KShs.	
Direct Labor Costs	3,508,437	4,981,791	1,473,354	42%

Expenditures Considered Unreasonable

Line Item	1985/86	1986/87	1986/87	DIFFERENCE
Overstated	Billed	Reasonable	Unreasonable	
		Per (net adj.) (a) x 142%		
	(a)	(b)	(c)	(d) = (c)-(b)
	KShs.	KShs.	KShs.	KShs.
Office salary and wages	850,000	1,207,000	1,677,871	470,871
Printing and stationary	125,759	178,578	577,527	398,949
Motor vehicle and travel	142,022	201,671	269,853	68,182
Miscellaneous	77,398	109,905	210,043	100,138
Postage, Tel, Fax, Courier	243,486	345,750	498,519	152,769
				1,190,909
Partners Administration	351,159	498,646	744,402	245,756
				1,436,665

(f) Direct Labor Costs 1986/87

Direct labor costs per the PWA Nairobi overhead rate computation schedule were overstated by Kshs.831,194. The labor/cost analysis schedule overstated the compensation of two employees by a total of Kshs998,082 and questioned Peter Cody's direct time of negative Ksh.166,888 which was originally excluded by PWA. Legal expert and Contracting Officer concluded that Cody's direct time should be included. Hence we questioned Cody's costs.

(g) Overhead Labor Costs 1986/87

Overhead labor costs per the PWA Nairobi overhead rate computation schedule were overstated by Kshs.173,413 due to the reasons explained in (F) above. This cost was also overstated by Kshs.70,956 because of a misallocation between fringe benefits and overhead costs for two employees.

(h) Fringe Labor Costs 1986/87

Fringe labor costs per the PWA Nairobi overhead rate computation schedule were overstated by Kshs.18,422 because of the reasons mentioned in (F) above. However these costs were understated by Kshs.70,956 due to the misallocation between fringe benefits and overhead costs. (See "G" above)

(i) Partners Administration Costs 1986/87

Partners Administration costs were overstated by disallowable costs of Shs.201,544 because of the reasons mentioned in Note D Exhibit 4. In addition we questioned Kshs.245,756 because the partners administration costs for 1986/87 appeared unreasonably high compared to Fiscal Years 1985/86 and 1987/88. Based on our judgment, we questioned the amount which we considered excessive in relation to the other fiscal years.

(j) Overhead Expenses 1986/87

Overhead expenses were overstated by disallowable costs of Kshs.364,915. This included entertainment, golf sponsorship competition, a luncheon party, cost of a business guide book and hotel bills considered unacceptable. It also included a gain on the disposal of fixed assets totaling Kshs.122,963. We questioned expenditures totaling Kshs.308,601 which were not supported by vouchers. We also questioned Kshs.1,190,909 which, in

Note: Notes A-E are reflected in Exhibit 4.

our opinion, were excessive and unreasonable compared with expenditures in 1985/86 and 1987/88. These questioned expenditures included office salary and wages of Kshs.470,871 (reason: the amount could have been misallocated from professional staff direct costs); printing and stationery Kshs.398,949 (reason: excess cost related to production of brochures which we considered a form of advertisement); Miscellaneous expenses Kshs.100,138 (reason: costs could have been misallocated from non allowable sources such as professional direct costs, donations etc); motor vehicle expenses Kshs.68,182 (reason: costs misallocated i.e. instead of posting personal car expenses to partners drawing account, the related costs could be posted in this account); and Postage, Tel, Fax, Courier Kshs.152,769 (reason: costs incurred for and on behalf of the clients which were not recharged to clients). The above explanations were given to us by a Price Waterhouse Nairobi Financial Accountant.

(k) Head Office Expenses (Worldwide) 1986/87

We offset partners time credits allocated from the Head Office totalling Kshs.344,845 because the expenditures relating to travel and accommodation by partners attending local and offshore assignments and conferences were included in overhead expenditures. Thus income related to such assignments should be offset against overhead expenditures.

Schedule Of Price Waterhouse, Associates Nairobi Overhead Rate Computation-Period 12 Months To June 30th 1988

	PWA-Nairobi O/H Schedule Kshs.	Audited and Accepted Kshs.	Disallow Kshs.	Question Kshs.	Note
Direct Expenses					
Direct Labor Costs	6,945,487	7,680,866	403,312	(1,138,691)	(1)
Indirect Expenses					
Overhead Labor costs	5,475,686	5,290,189	185,497		(m)
Fringe Labor costs	2,010,795	2,010,870	(75)		(n)
Partners Administration Costs	702,293	552,778	149,515		(o)
Overhead expenses	6,187,801	4,417,152	1,228,703	541,946	(p)
Head office allocation (Worldwide)	1043491	686027	357,464	-	(q)
Total Indirect expenses	15,420,066	12,957,016	1,921,104	541,946	
Percentage of Indirect to Direct Expenses	222.02%	168.69%			

Note: If questioned costs were disregarded, the audited overhead Rate would be 206.3%

NOTES:

(1) Direct Labor Costs 1987/88

Direct labor cost per the Price Waterhouse, Nairobi overhead rate computation schedule were understated by Kshs.735,379 because the labor cost analysis schedule contained calculation errors totalling Kshs.403,312, and questioned Peter Cody's direct time which totalled Kshs.1,138,691. Mr. Cody's cost was originally omitted from PWA's labor cost schedules.

(m) Overhead Labor Costs 1987/88

Overhead labor costs per the Price Waterhouse, Nairobi overhead rate computation schedule were overstated by Kshs.185,497 because the labor cost analysis schedule contained calculation errors totalling Kshs.163,164 and an error in the timesheet analysis for Matende Wabuyele and Nimish Shah overstated overhead labor cost by Kshs.22,333.

(n) Fringe Labor Costs 1987/88

Fringe labor costs per the Price Waterhouse, Nairobi labor cost analysis schedule were understated by Kshs.75.

(o) Partners Administration Costs 1987/88

Partners Administration costs per the Price Waterhouse Nairobi overhead rate computation schedule, were overstated by Kshs.149,515 due to the reasons explained in (d) above.

(p) Overhead Expenses 1987/88

Overhead expenses were overstated by disallowable costs of Kshs.1,228,703. These disallowable costs included entertainment, advertisement, motor vehicle account errors, charitable contributions and equipment rental posting errors. These overcharges were reduced by miscellaneous income totalling Kshs.454,130 and the gain on the sale of fixed assets totalling Kshs.37,383. We also questioned expenditures worth Kshs.541,946 because the supporting vouchers were missing.

(q) Head Office Expenses (Worldwide 1987/88

Partner's time credits totalling Kshs.357,464 were allocated from the PWA Head office and offset against overhead expenditures. This offset was made because all the expenditures related to travel and accommodation by partners attending local and offshore assignments and conferences were included in overhead expenditures. Thus income related to such assignments was offset against overhead expenditures to overhead expenditures.

EXPLANATORY NOTES

1. Direct Costs and Salaries

(a) Total direct costs charged to the AMP, KARI and CIP contracts did not exceed the maximum amounts set forth in the respective contracts as of December 31, 1988.

(b) We were not allowed to analyze Price Waterhouse's revenue accounts to determine if PWA earned any interest income from the excess A.I.D. funds. However, during our review nothing came to our attention which would lead to conclude that interest was earned on excess A.I.D. fund.

(c) We were only allowed to review professional staff costs of the management consulting department. We were not allowed to review personnel costs of other PWA departments. The personnel costs were supplied to us in the form of total salary compensation categorized into direct costs, fringe benefits and overhead. Direct hours represented hours charged to clients, whereas fringe benefit hours represented hours charged to sick leave, annual leave and holidays. Overhead hours included hours charged to internal work not chargeable to clients such as general administration; continuous education, staff development, practise development, and business development. The total salary compensation included all payments made to an employee after normal negotiation was completed and an agreement written and signed by both parties. The breakdown is designed to be income tax efficient and effective. Thus only a portion of the salary compensation is composed of taxable basic salary. The other portion is made up of business meals; medical insurance; papers; club subscriptions; keyman insurance, car allowance, etc. However, for the purpose of our computations, the partners costs were computed using the highest Foreign Service rate as stipulated by A.I.D. regulations. Price Waterhouse Nairobi charged fringe benefit costs to A.I.D. at a higher rate than the rate actually supplied for audit purposes. These errors were quantified and reported in the footnotes in Exhibits 4, 5 and 6.

2. Fringe Benefits

Fringe benefits costs related to the proportion of total salary compensation which was computed by multiplying the total number of fringe hours (charged to sick leave, statutory leave and annual leave) and dividing that product by total number of hours spent by an employee (which includes fringe hours, direct labor hours and overhead hours).

3. Indirect Costs

We disallowed expenditure costs in accordance with the criteria of Part 31 of the Federal Acquisition Regulations. These disallowed costs are detailed under footnotes in Exhibit 4, 5 and 6.

It should be noted that we were not given a copy of the previous indirect cost rate computation and thus we cannot comment on the consistent treatment of costs over the years.

However, despite the various misallocation errors noted, the accounts reflected the proper classification of indirect costs. It should also be noted that due to the nature of the audit assignment, we did not perform any work relating to other PWA clients. We were not allowed to review PWA's accounting records relating to other clients as it was considered confidential by the contractor.

4. Computation Of Overhead Rate

The rates we audited were as follows:

(a) Fringe Rate
(b) Overhead Rate
(c) Multiplier Rate (Fringe Rate + Overhead Rates)

The following reflects the formula used to compute each of the above rates:

(a) Fringe Rate = Total Fringe Cost of Charging Staff divided by (Overhead Labor Cost + Direct Labor Costs).

(b) Overhead Rate = Overhead Cost Pool* divided by (Total Direct Labor + Fringe Labor Cost)

* Overhead Cost Pool = Overhead Expenses + Overhead Labor Cost + Fringe on overhead labor cost at above fringe rate.

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(c) Multiplier Rate = Indirect expenses divided by direct labor costs*

* Indirect Expenses = Overhead Labor Costs + Fringe Labor Costs + Overhead Expenses + Head Office Allocation (Worldwide Costs) + Partners Adm. Costs

We also proved that these formulas were correct and that they agreed. (Please see Exhibit 3 Page 2 of 2).

	1985/86	1986/87	1987/88
Audited Fringe Rates	14.59%	9.19%	15.50%
Audited Overhead Rates	130.57%	160.41%	132.63%
Audited Overhead Loading rates	164.22%	184.35%	168.69%

5. Comparison of Billing Rates

We noted that PWA only charged USAID/Kenya based on the use of an overhead rate. PWA's other clients were charged based on various hourly rates for their services provided. The hourly rates charged to PWA's other clients were different from the rates charged to USAID/Kenya because the rates charged other clients included overhead and profit factors. For example in fiscal year 1987/88 a project manager's time was charged to clients at Kshs.2,000 per hour, whereas his hourly compensation cost to PWA was Kshs.334 per hour. This mark up was 598.8% which was approximately 2 1/2 times higher than the audited rate. Based on this, we feel the audited mutiplier rates applied by PWA to the USAID/Kenya projects are reasonable.

6. Viability

We were unable to render an opinion concerning the financial viability of PWA Nairobi because we only audited overhead expenditures, overhead rate computations and PWA's records relating to the three USAID/Kenya projects which reviewed overhead expenditures, overhead rate computations and AID-contracts.

PWA's financial statements, and other sections of the ledger were not accessible to auditors because PWA considered these documents confidential.

Audit of Financial Statements

Comments:

(a) We only reviewed extracts of the overhead schedules of the financial statements. Price Waterhouse Associates refused to allow us to review other components of the financial statements.

(b) We did not audit the revenue section of the income statement and the balance sheet accounts.

(c) We were unable to reconcile all direct costs to the income statements because we were only allowed to audit those direct costs relating to the Management Consulting Department.

Results

i Various weakness were noted which are incorporated in the Finding No. 2.

ii Material costs which we considered unacceptable or which did not satisfy the audit tests for allowability, allocability and a acceptability in accordance with contract provisions are listed in Exhibits 4, 5 and 6.

NGANGA AND ASSOCIATES
(Certified Public Accountants)
P.O. Box 67120
Tel: 25127/29908
Nairobi (Kenya)

Our Ref: Your Ref: DATE

REPORT ON INTERNAL ACCOUNTING CONTROL OF
PRICE WATERHOUSE ASSOCIATES, NAIROBI
FOR THE PERIOD JULY 1, 1985 TO JUNE 30, 1988

We have examined the schedule of Price Waterhouse Associates, Nairobi, Overhead Rate Computation for the period July 1, 1985 to June 30, 1988, and have issued our report thereon dated September 26, 1989. As part of our examination, we made a study and evaluation of Price Waterhouse Associates, Nairobi system of Internal Accounting Control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards and the standards for the financial and compliance audits contained in the U.S. General Accounting Office's Government Auditing Standards (1988 Revision). For the purpose of this report, we have classified the significant internal accounting control in the following categories: (a) cash disbursement, (b) time keeping and recording system (c) contractor filing system (d) cancellation of paid invoices/ vouchers (e) approval and recording of journal vouchers (f) recording of ledgers and trial balances. Our study included all of the control categories listed above except that we did not evaluate the accounting controls over: (i) revenues, and (ii) financial statements for the fiscal years under consideration. This is because Price Waterhouse Associates - Nairobi considered us as potential competitors and hence withheld revenue and financial statements details and information. However, we did not understand why the external auditors management reports were not availed for our review.
The purpose of our study and evaluation was to determine the nature, timing and the extent of the auditing procedures necessary for expressing an opinion on the schedule of Price Waterhouse Associates, Nairobi Overhead Rate Computation. Our study and evaluation was more limited than was necessary to express an opinion on the system of internal control taken as a whole or on any of the categories of controls identified above.

The management of Price Waterhouse Associates, Nairobi is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide

NGANGA AND ASSOCIATES
(Certified Public Accountants)

P.O. Box 67120
Tel: 25127/29908
Nairobi (Kenya)

Our Ref: Your Ref: DATE

management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of the inherent limitations in any systems of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation, made for the limited purpose described in the first paragraph, would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of Price Waterhouse Associates, Nairobi taken as a whole or any of the categories of controls identified in the first paragraph. However, our study and evaluation disclosed various weaknesses as reported in the findings of the main report.

Contractor information contained in this report may be priviledged. The restrictions of 18 USC 1905 should be considered before any information is released to the public. This report is intended solely for the use of management of Price Waterhouse Associates or the Agency for International Development and should not be used for any other purpose.

NG'ANG'A AND ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

SIGNED ____________________
DATE: May 11, 1989

NGANGA AND ASSOCIATES
(Certified Public Accountants)

P.O. Box 67120
Tel: 25127/29908
Nairobi (Kenya)

Our Ref: Your Ref: DATE

EXHIBIT 9

REPORT ON SCHEDULE OF PRICE WATERHOUSE ASSOCIATES, NAIROBI
OVERHEAD RATES COMPUTATION
FOR THE PERIOD JULY 1, 1985 TO JUNE 30, 1988

We have examined the schedule of Price Waterhouse Associates, Nairobi Overhead Rate Computations for the three fiscal years covering the period July 1, 1985 to June 30, 1988. Our examination was made in accordance with generally accepted auditing standards and the U.S. Comptroller General's "Government Auditing Standard" (1988 Revision) and, accordingly included such tests of the accounting records and such other auditing procedures, as we considered necessary in the circumstances.

It is Price Waterhouse Associates' accounting policy to prepare its schedule of Price Waterhouse Nairobi Overhead Rate computation on a basis outlined by the terms and conditions of the agreements with the Agency for International Development and the applicable U.S. Government laws and regulations. Accordingly, after our audit and subsequent revisions of schedules presented to us, the accompanying schedule of Price Waterhouse Associates, Nairobi Overhead Rates Computation is presented in conformity with generally accepted accounting principles.

In our opinion, the schedule of Price Waterhouse Nairobi Overhead Rate Computation as audited presents fairly the incurred direct costs and the Overhead Rate Computation of Price Waterhouse Associates, Nairobi during the period July 1, 1985 to June 30, 1988 in accordance with the terms and conditions of the Agency for International Development agreements and the applicable U.S. Government laws and regulations on a basis consistent with each of the three fiscal years under consideration.

Contractor information contained in this report may be priviledged. The restrictions of 18 USC 1905 should be considered before any information is released to the public. This report is intended solely for the use of management of Price Waterhouse or the Agency for International Development and should not be used for any other purpose.

NG'ANG'A AND ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

SIGNED

DATE: May 11, 1989

NGANGA AND ASSOCIATES
(Certified Public Accountants)

P.O. Box 67120
Tel: 25127/29908
Nairobi (Kenya)

Our Ref: Your Ref: DATE

EXHIBIT 10

REPORT ON COMPLIANCE WITH LAWS, REGULATIONS AND A.I.D. AGREEMENTS OF PRICE WATERHOUSE ASSOCIATES, NAIROBI FOR THE PERIOD JULY 1, 1985 TO JUNE 30, 1988

We have examined the schedule of Price Waterhouse Associates , Nairobi Overhead Rate Computation for the period July 1, 1985 to June 30, 1988 and have issued our report thereon dated September 26, 1989. Our examination was made in accordance with generally accepted auditing standards; the provisions of "Government Auditing Standards" (1988 Revision) promulgated by the U.S. Comptroller General, as they pertain to financial and compliance audits, and accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The management of Price Waterhouse Associates, is responsible for Price Waterhouse Associates' compliance with laws, regulations, and terms and conditions of the Federal Award Agreements.

In connection with our examination, we found that for the items tested; Price Waterhouse Associates, Nairobi complied with laws, regulations and the terms and conditions of the Federal award Agreements except as concerns matters reported in the Finding Nos. 1, 2, and 3.

Further, with respect to the items not tested by us, nothing came to our attention to indicate that Price Waterhouse Associates, Nairobi had not complied with laws, regulations, and the terms and conditions of the Federal Award Agreements. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of noncompliance with such requirements, terms and conditions.

Contractor information contained in this report may be priviledged. The restrictions of 18 USC 1905 should be considered before any information is released to the public. This report is intended solely for the use of management of Price Waterhouse or the Agency for International Development and should not be used for any other purpose.

NG'ANG'A AND ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

SIGNED ______________________
DATE May 11, 1989

45

NGANGA AND ASSOCIATES
(Certified Public Accountants)

P.O. Box 67120
Tel: 25127/29908
Nairobi (Kenya)

Our Ref: Your Ref DATE

EXHIBIT 11

REPORT ON SUPPLEMENTAL INFORMATION OF
PRICE WATERHOUSE ASSOCIATES, NAIROBI
FOR THE PERIOD JULY 1, 1985 TO JUNE 30, 1988

We have examined the schedule of Overhead Rate Computation of Price Waterhouse Associates, Nairobi for the period July 1, 1985 to June 30, 1988. Our examination was made for the purpose of forming an opinion on the schedule of Overhead Rate Computation taken as a whole. The attached exhibits are presented for the purpose of additional analysis and are not a required part of the basic schedule of Overhead Rate Computation. Such information has been subjected to the auditing procedures applied in the examination of the basic schedule of Overhead Rate Computation and, in our opinion, after audit adjustments, is fairly stated in all material respects in relation to the basic schedule of Overhead Rate Computation taken as a whole.

NG'ANG'A AND ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

SIGNED ____________________

DATE May 11, 1989

UNITED STATES GOVERNMENT

memorandum

DATE: September 22, 1989

REPLY TO ATTN OF: Eric Zallman, Acting Director, USAID/Kenya

SUBJECT: Audit of Price Waterhouse Associates Activities in Kenya under three A.I.D. Contracts.

TO: Richard Thabet, Director, RIG/A/N

We have finished the review of the subject draft audit report and have no objection to the recommendations as presented. USAID/Kenya notes with concern that you identified the existence of deficiencies in the contractor's system of internal controls and the property management system. We trust you have contacted the contractor directly for his comments and necessary action. These deficiencies have to be rectified to ensure that the contracts' provisions are complied with and that A.I.D. is assured of receiving the original contracts' intended services.

8013A

UNITED STATES GOVERNMENT

memorandum

Nick / Jno K

KT

DATE: September 27, 1989

REPLY TO ATTN OF: Thomas A. Totino, Mission Controller T

SUBJECT: Audit of Price Waterhouse Associates Activities in Kenya under three A.I.D. contracts

TO: Richard C. Thabet, RIG/A/N

Attached please find comments regarding subject draft report that we recently received from the USAID/Kenya Office of Agriculture.

Although the deadline for submission of comments was 9/25/89, we hope that these comments can be incorporated in your final report.

8021A

OPTIONAL FORM NO. 10
(REV. 1-80)
GSA FPMR (41 CFR) 101-11.6
5010-113

☆ GPO : 1985 O - 461-275 (348)

UNITED STATES GOVERNMENT
memorandum

DATE: September 25, 1989

REPLY TO ATTN OF: James Gingerich, Office of Agriculture

SUBJECT: Draft Report of Non-Federal Audit of Price Waterhouse Contracts under Commodity Import Program, Agricultural Management Project and National Agricultural Research Project

TO: Mr. Tom Totino, CONT

We have received subject draft audit report. With one exception we have no objections to its conclusions. The objection is on page 26 of the draft report.

To clarify why the Landrover was loaned: Another AID project - IDAT - also located at Egerton required a vehicle for a 3-4 month period to carry out field research. We queried both PW and Egerton personnel regarding the possibility of loaning the landrover to IDAT for that period. Egerton University, at our request, loaned the vehicle to the IDAT project. Why this was extended to 7 months, we do not know. Recently, the Vice-Chancellor of Egerton clarified the University's policy on vehicle use which meshes with AID policy on project use. We believe this particular issue has been addressed properly by the University.

RECEIVED
26 SEP 1989
CONTROLLER KENYA

Clearance: AGR:MMullei MM

Price Waterhouse Associates Limited

Management Consultants

Rattansi Educational Trust Building
Koinange Street
P O Box 43963
Nairobi Kenya

Telephone 21244
Telecopier 254-2-335937
Telex 22140 CHUNGA
Cables PRICEWATER

Price Waterhouse Associates

22 September 1989

Mr R Thabet
United States of America Agency for
International Development
Regional Inspector General/Audit
Sonalux Building
NAIROBI

Dear Mr Thabet

We have reviewed the draft audit report entitled "Audit of Price Waterhouse Associates Activities in Kenya under three AID Contracts".

As you are aware following our meeting of 21 September 1989 we have a number of very serious concerns about the contents of the report.

In the appendix to this letter we discuss only our more serious concerns. In the interests of brevity and clarity we will deliver the remainder of our comments in the form of margin notes on the draft report which is returned to you with this letter.

We recognise that this has probably been a long and frustrating exercise for your office, and we appreciate the time and effort you are expending to resolve these matters. However, we have also been required to expend considerable senior management time and effort. And we are particularly frustrated that issues which we have explained and apparently resolved with the auditors continually reappear.

We hope that our comments are clear and understable, and we look forward to any opportunity to further discuss them with you and your staff.

Yours sincerely

Andrew Hollas

Attachment
WAH/jm

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COMMENTS ON RIG/A/N DRAFT AUDIT REPORT

1. Legal Entities

Price Waterhouse Associates (PWA) is located in Nairobi and is the economic entity that is currently the subject of the RIG audit. PWA is a part of the Price Waterhouse Africa partnership. Price Waterhouse Office of Government Services (OGS), headquartered in Washington DC, is a separate legal entity being a part of the Price Waterhouse United States partnership. Both entities may trade under the name of Price Waterhouse but they are completely separate legally, organisationally and financially. The recognition of this distinction is crucial to the understanding of the operations of PWA and the correct performance of the contemplated audit.

Despite repeated explanations on our part, the audit team has failed to incorporate this distinction into the report. Two particular examples apply.

A. Mr Peter Cody

Mr Peter Cody was the project manager on the Agricultural Management Project (AMP) contract signed by PW OGS. Audit investigation would have confirmed that no labour costs relating to Mr Cody are accounted for in PWA accounting records. He was hired, managed and paid by the OGS Washington office. PWA supplied staff to Mr Cody whom he managed on this contract.

The audit team continues to insist that Mr Cody is an employee of PWA and/or that he should be included in the direct labour base of allocation for the indirect expenses of PWA Nairobi. This is absolutely incorrect and we do not see any justification for the auditor's treatment other than it produces sensational questioned costs.

This fundamental misunderstanding quickly presents itself in the report on page (i) of the executive summary. The auditors state that the AMP contracts was signed by PWA when in fact it was signed by PW OGS.

The auditors then perform their calculations of the PWA overhead rates assuming that P Cody is an employee (see Exhibit 5, page 3 and Exhibit 6, page 1). We estimate that the erroneous inclusion of Mr Cody results in the understatement of the PWA overhead rate by approximately 30 percentage points in fiscal year 1988. Clearly this issue has a profound effect on the accuracy of the entire audit report as this overhead rate is then applied to all three contracts under review.

B. Ms P Kabbes

The auditors have recomputed the manner in which direct labour hourly rates are calculated under the KARI contract (see Exhibit 1, page 4). We have no disagreement with the conceptual position taken by the auditors on this mathematical aspect of the contract as the net effect is merely to remove the fringe costs from the hourly rate and establish them as a separate indirect cost element. The auditors failed to recognise that Ms Peggy Kabbes is not an employee of PWA and is in fact an employee of PW OGS. Her hourly rate had been calculated in accordance with the auditors prescribed method since the beginning of the contract. Like Mr Cody she is hired, managed and paid by PW OGS. The auditors did not recognise this and in fact questioned costs related to her salary. We believe that after our September 21 meeting they are finally prepared to recognise this error.

More importantly, this individual is not an employee of PWA and her costs should never have been subject to review. Similarly, the overhead rate calculated for PWA will not apply to her, she is covered by the PW OGS overhead rate.

2. Fiscal Year Indirect Rates

The audit team has computed the indirect expense rates for fiscal year ending 30 June 1988, (see Exhibit 6, page 1). They have applied these indirect rates to all contract costs incurred from 1 July 1987 through 30 December 1988. Thus the fiscal year rates have been applied to that year and to six months of the following year.

While we understand that the audit objectives included the review of the contracts through December 1988, it is impossible to determine what the overhead rate is for a fiscal year until that year is completed. It is equally inappropriate to disallow contract costs on the basis of applying a previous year's indirect rates to a later year.

GV

3. Extrapolation

The audit team concluded that specific categories of indirect expenses had been overstated and in their opinion should be reduced (see Exhibit 5, page 2). This resulted in the reduction of the overhead by approximately 28 percentage points. Since this indirect rate was applied across the board, this had the immediate impact of inflating the questioned costs for all three contracts.

The auditors have not explained what evidentiary matter demonstrates that the costs are overstated in this year. We do not believe that they exercised sound judgment in concluding that "these expenditures should be reduced ...", and we feel that the extrapolation formula used is grossly inappropriate.

The technique used by the auditors to calculate questioned costs simplisticly assumes that there is a directly proportionate relationship between the increase in direct labour costs and the increase in allowable indirect expenses such as printing, office salaries, miscellaneous, motor vehicle and postage. The auditors further assume that this direct relationship applies in an environment where the direct labour base is growing at a rate of 42% per year and that a single year's history is sufficient to demonstrate and perform this unallowable cost extrapolation.

We believe that this position is unsupportable in light of the language and intentions of the Federal Acquisition Regulation cost principles. To question costs such as postage because they exceed some artificially constructed percentage fails to understand the concept that an expense is allowable unless it is specifically identified as unallowable. We do not believe that the auditors have demonstrated the unallowable nature of any such expenses.

4. Inflammatory Language

Price Waterhouse objects to the auditor's use of inaccurate and inflammatory language. We feel that the use of such language does not serve to forward the interests of either party and that it fosters an adversarial relationship by subjecting us to the risks of misconstruction and emphasis out of context should the report be seen by third parties.

Page 4

In particular we refer to the description of the internal control system as "not adequate and effective" (see page (ii) of the Executive Summary), the statement that "$5.9 million were subject to fraud, waste and mismanagement." (see page (iv) of the Executive Summary and page 16), and assessment that the time keeping system "was vulnerable to errors and unable to detect errors". (see page 19).

APPENDIX 2

REPORT DISTRIBUTION

American Ambassador to Kenya	1
Mission Director, USAID/Kenya	5
Price Waterhouse Associates, Kenya	1
REDSO/ESA/RCO	1
AA/AFR	1
AFR/EA/KUTRB	1
AFR/CONT	1
AA/XA	2
XA/PR	1
LEG	1
GC	1
AA/M	2
AA/PFM	1
SAA/S&T	1
PPC/CDIE	3
REDSO/ESA	1
RFMC/Nairobi	1
IG	1
DIG	1
IG/PPO	2
IG/LC	1
IG/ADM/C&R	12
AIG/I	1
RIG/I/N	1
IG/PSA	1
RIG/A/C	1
RIG/A/D	1
RIG/A/M	1
RIG/A/S	1
RIG/A/T	1
RIG/A/W	1