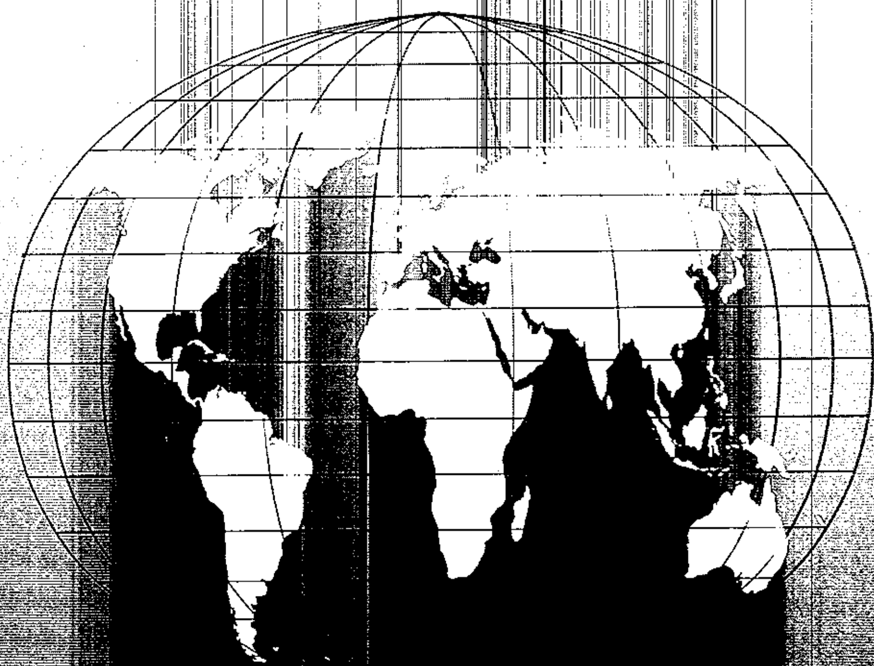
Report of Audit

Concurrent Agency-contracted Audit of USAID/Mozambique's Resources Managed by Deloitte & Touche under Emergency Recovery: Enterprise Credit Contract 656-0-00-00066-00 for the Period November 1, 2000 to October 31, 2001

Report No. 4-656-02-006-N
May 15, 2002



USAID

Regional Inspector General
Pretoria

May 16, 2002

MEMORANDUM FOR MISSION DIRECTOR, USAID/MOZAMBIQUE

FROM: Regional Inspector General/Pretoria, Joseph Farinella Joseph Farinella

SUBJECT: Concurrent Agency-contracted Audit of USAID/Mozambique's Resources Managed by Deloitte & Touche under Emergency Recovery: Enterprise Credit Contract 656-0-00-00066-00 for the period from November 1, 2000 to October 31, 2001, Audit Report No. 4-656-02-006-N

Attached is a report of the subject audit performed by Ernst & Young, Maputo, Mozambique.

The report was prepared in accordance with generally accepted auditing standards and the U.S. Government Auditing Standards issued by the Comptroller General of the United States.

In August 2000, the U. S. Agency for International Development (USAID), mission to Mozambique approved the Emergency Recovery: Agriculture and Commercial Trade Program, (ER: ACT), which provided $42 million in grant funds to the Government of Mozambique for emergency recovery action from the 2000 floods. ER: ACT is composed of two major programs, an Economic Recovery Component and an Emergency Mitigation Component. The subject of this scope of work is a review of the Enterprise Credit activity under the Economic Recovery Component.

Management of the four Economic Recovery activities (Family Resettlement Grants, Inventory Credit, Micro-finance Grants and Enterprise Reconstruction Loans) was contracted to Deloitte and Touche (D&T). Under a direct reimbursable management contract, D&T established the Project Management Unit (PMU). The primary responsibility of the D&T/PMU was to design an implementation system with financial controls and management mechanisms for the four Economic Recovery activities listed above. By April 2001, the budget for ER: ACT had been revised and the D&T contract altered accordingly. As a result, the Microfinance Grants activity was cancelled and the Inventory Credit activity was subsumed in its entirety under the Enterprise Credit activity. The resulting Enterprise Credit activity represents a $22 million pool of resources available for short-term (3 month) and long-term (up to 5 year) loans to the flood-affected clients in the private sector. These resources are held in an interest bearing

Project Account at the Banco Comercial e de Investimentos.

In order to implement this activity, the PMU negotiated a Participating Financial Institution Agreement with eligible financial institutions (banks and leasing companies) that outlines the terms and conditions under which eligible financial institutions may channel these resources to their flood-affected clients. The Agreement stipulates the client eligibility requirements; limits the interest rate charged to the client to between 8 and 10%; sets the credit limit (originally established at the Metical equivalent of $100,000 and subsequently revised to the Metical equivalent of $250,000); as well as the risk sharing mechanism (even risk sharing between participating financial institution and the project on values up to $100,000, and 100% participating financial institution risk on the value between $100,000 and $250,000). The agreement penalizes participating financial institutions for not disbursing loans to clients within 30 days of receiving such funds from the central account. A total of 15 financial institutions signed this Agreement, with approximately half that number submitting loan requests as of October 31, 2001.

The objective of this engagement was to review the D&T/PMU developed framework for tracking the flows of financial resources made available to the flood-affected private sector under the Enterprise Credit activity.

The audit included a review of:

- the financial tracking framework;
- participating banks compliance with the terms and conditions stipulated in the Participating Bank Agreement;
- participating banks' clients and the use to which loan proceeds were put; and
- interest and capital repayments as well as penalties incurred for delays in loan disbursements from participating bank accounts to clients.

The reports on internal controls and compliance presented no reportable conditions with the PMU. However, the report disclosed instances of non-compliance by local banks:

- detailed bank statements and approved amortization schedules not always submitted;
- reconciliation reports not always submitted;
- documentation showing that loanees were flood-affected victims not provided to the PMU;
- delays in providing funds to clients and paying resulting penalties; and
- loans granted to group entities based on a group (rather than individual) guarantee.

Therefore, we are making the following recommendations:

<u>Recommendation No. 1:</u> We recommend that USAID/Mozambique develop a plan to ensure that participating banks comply with all agreement terms including: (1) the prompt disbursement of loans and whether penalties are due and (2) submitting all required statements, schedules, reports and documentation in a timely manner.

<u>Recommendation No. 2:</u> We recommend that USAID/Mozambique develop a plan to ensure that individual guarantees are provided for loans made to each entity.

Please respond within 30 days describing the actions taken or planned by USAID/Mozambique to address the above recommendations.

Attachments: a/s

Ernst & Young

AUDIT OF THE USAID FUNDS GRANTED TO
ER: ACT ENTERPRISE CREDIT ACTIVITY
MANAGED BY DELOITTE & TOUCHE
FOR THE PERIOD FROM

November 1, 2000 to October 31, 2001

AUDIT OF THE USAID FUNDS GRANTED TO ER: ACT ENTERPRISE CREDIT ACTIVITY MANAGED BY DELOITTE & TOUCHE
FOR THE PERIOD FROM NOVEMBER 1, 2000 TO OCTOBER 31, 2001

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Ernst & Young

1. TRANSMITTAL LETTER AND SUMMARY

The Director
United States Agency for International Development
Mission to Mozambique
Av. Damião de Góis, 165
Maputo, Moçambique

Dear Sir or Madam

Audit of USAID Resources Managed by Deloitte & Touche
Contract No. 656-C-00-00066-00

We have completed our audit of the above grant for the period *November 1, 2000 to October 31, 2001 and report as follows:*

1.1 Background

In August 2000, the U. S. Agency for International Development (USAID), mission to Mozambique approved the Emergency Recovery: Agriculture and Commercial Trade Program, (ER: ACT), which provided $42.0 million in grant funds to the Government of Mozambique for emergency recovery action from the 2000 floods.

ER: ACT is composed of two major programs:
- an Economic Recovery Component; and
- an Emergency Mitigation Component.

Management of the four Economic Recovery activities (Family Resettlement Grants, Inventory Credit, Micro-finance Grants and Enterprise Reconstruction Loans) was contracted to Deloitte and Touche (D&T). Under a direct reimbursable management contract, D&T established the Project Management Unit (PMU). The primary responsibility of the D&T/PMU was to design an implementation system with financial controls and management mechanisms for the four Economic Recovery activities listed above.

By April 2001, the budget for ER: ACT had been revised and the D&T contract altered accordingly. As a result, the Micro finance Grants activity was cancelled and the Inventory Credit activity was subsumed in its entirety under the Enterprise Credit activity. The resulting Enterprise Credit activity represents a $22 million pool of resources available for short- (3 month) and long-term (up to 5 year) loans to the flood-affected clients in the private sector.

These resources are held in an interest bearing Project Account at the Banco Comercial e de Investimentos (BCI). In order to implement this activity, the PMU negotiated a Participating Financial Institution Agreement with eligible financial institutions (banks and leasing companies) that outlines the terms and conditions under which eligible financial institutions may channel these resources to their flood-affected clients.

The Agreement stipulates the client eligibility requirements, limits the interest rate charged to the client to between 8 and 10%, sets the credit limit (originally established at the Metical equivalent of $100,000 and subsequently revised to the Metical equivalent of $250,000), as well as the risk sharing mechanism (50%-50% risk sharing between the participating financial institution and the project on values up to $100,000, and 100% participating financial institution risk on the value between $100,000 and $250,000).

A total of 15 financial institutions signed this Agreement, with approximately a third that number submitting loan requests to date. As at 31 October 2001 these included:

Banco Comercial de Moçambique, SARL
Banco Standard Totta de Moçambique, SARL
Banco de Fomento, SARL
Banco Internacional de Moçambique, SARL
Banco Internacional de Moçambique Leasing, SARL
Banco Austral, SARL
Banco Comercio e Investimento, SARL
Banco Comercio e Investimento Leasing, SARL
Credicoop, SARL
GAPI

A subsequent regulation approved in July 2001, further refined the responsibilities of participating financial institutions by penalizing them for not disbursing loans to clients with approved loans within a 30 day period from disbursement from the Project Account to the participating financial institution.

1.2 Audit objectives, scope and scope limitations

1.2.1 Audit objectives and scope

The purpose of this scope of work is to conduct a review of the Enterprise Credit activity with particular attention to evaluating the soundness of the control systems established to track the financial flows under that activity. The soundness of the financial tracking system is of utmost importance to the Mission, as responsibility for accounting for the financial flows will revert to USAID's Office of Financial Management upon completion of the D&T contract in September 2002.

The services to be provided are essentially the performance of an audit of the Project Management Unit (D&T) financial tracking system for the Enterprise Credit Activity under the Emergency Recovery: Agriculture and Commercial Trade Program (ER: ACT) for the period November 1, 2000 to October 30, 2001.

The objective of this engagement is to review the D&T/PMU-developed framework for tracking the flows of financial resources made available to the flood-affected private sector under the Enterprise Credit activity.

The audit included:

- *a review of the financial tracking framework;*
- *a review, on a sample basis, of participating banks compliance with the terms and conditions stipulated in the Participating Bank Agreement;*
- *a review, on a sample basis, of the participating banks' clients and the use to which loan proceeds were put; and*
- *a preliminary review, on a sample basis, of interest and capital repayments as well as penalties incurred for delays in loan disbursements from participating bank accounts to clients.*

1.2.2 Scope limitations

1. The following Credit Account Reconciliation Reports had not been provided for the period under review to the Program Management Unit (PMU) by the respective banks as required per the credit agreements:

   - Banco Comercial de Moçambique
   - Banco Internacional de Moçambique.

   We were thus unable to review these reconciliation reports for compliance with relevant credit agreement requirements as at 31 October 2001. Subsequent to the period covered by this audit report, certain information has been made available by the banks to the PMU.

2. The following Credit Account Repayment Reconciliation Reports have not been provided to the Program Management Unit (PMU) as required per the respective credit agreements.

   - Banco Austral
   - Banco Comercial de Moçambique
   - Banco Comercial de Investimento Leasing
   - Banco Internacional de Moçambique.
   - Banco de Fomento
   - Credicoop

   We are thus unable to review these reconciliation reports for compliance with relevant credit agreement requirements and hence meeting repayment obligations as at 31 October 2001. Subsequent to the period covered by this audit report, certain information has been made available by the banks to the PMU.

3. From the sample selected as per Annex A, almost all loan beneficiaries did not maintain funds received in separate bank accounts. Although not required in the agreement, from an audit perspective, we as auditors are unable to establish whether these funds have been utilized exclusively for the purposes set out in the respective loan agreements.

1.2.3 Methodology

Our audit has been performed according to the following methodology, which has been specifically tailored for projects of this nature and have included all procedures and tests that we considered necessary to allow us to express a professional opinion as required by the terms of reference.

Overall Planning and Identification of Areas of Audit Significance

We have reviewed all project specific documentation including:

- The agreement between USAID and the recipient (D&T/PMU) and its amendment;
- The sub-agreements of 6 November 2000 between the recipient (D&T/PMU) and the participating financial institutions, as well as the regulations of July 2001;
- Contracts and subcontracts with third parties, if any;
- The budgets, project implementation letters, and written procedures approved by USAID to manage the project;
- Standard Provisions Annex for Project Loan or Grant Agreements with Foreign Governments (USAID Handbook 3);
- Standard Audit Provisions for PL 480 Title II and III Agreements (USAID Handbook 9); and
- All project financial and progress reports; and charts of accounts, organizational charts; accounting systems descriptions; procurement policies and procedures; and receipt, warehousing and distribution procedures for materials, as necessary to successfully complete the required work.

An *entrance conference* was held with representatives of Deloitte & Touche / PMU and USAID on 24 October 2001.

Following our analysis of the relevant documents referred to above, we have:

- performed an overall assessment of the *internal control environment*;

  As regards our review of the internal control environment, we have reviewed and evaluated Deloitte & Touche PMU's internal control structure related to the ER: ACT Enterprise Credit activity to obtain a sufficient understanding of the design of relevant control policies and procedures and whether those policies and procedures have been placed in operation.

- prepared *audit programs*; and

- prepare a *Planning Memorandum* containing our findings and selected audit approach.

Develop and execute audit approach

We have planned our audit procedures to address the areas of high risk thereby avoiding the performance of excessive work in areas of low risk. The audit approach also takes into consideration the importance of the cost of performing the task and the best utilization of staff, allowing the auditor to exercise his judgement in selecting the most appropriate audit procedures.

Our audit procedures revolved around obtaining sufficient evidence to allow us to express an opinion on the specifically identified areas as detailed in the *Objectives* section above. Specifically, our review has included:

- a review of the Deloitte & Touche/PMU *Manual de Procedimentos do PMU* and an evaluation of whether the framework established and developed adequately captures resource flows under the Enterprise Credit activity.
- Testing whether the tracking framework is able to account for the flow of resources:

  - from the Project Account to the participating banks' accounts;
  - from the participating bank accounts to the clients;
  - from the clients back to the participating banks' amortization accounts for both capital and interest payments; and
  - from the participating banks' amortization account back to the Project Account.

- In addition, we have also tested whether the framework captures all penalties accrued due to arrears and defaults or devolution required to the Project Account.

- We attempted to perform a spot check of at least 10 percent of documentation files held on approved loans at the PMU for each participating bank to ascertain *due diligence* by the financial institutions in complying with the terms and conditions of the Participating Financial Institution Agreement. This included spot checks of individual loan applicants' files ensuring that they contain evidence of the client's flood affected status, a sound business proposal for eligible activities, and a financing plan that includes a loan repayment schedule. Due to its' recent takeover, Banco Austral was not part of the sample selected due to possible difficulties in obtaining information. Banco Standard Totta de Moçambique, SARL did not form part of our sample due to it holding only two loans and hence had a very small probability of one of its loans being selected.

- We attempted to perform of a spot check of 10 percent of the ER: ACT Enterprise Credit recipients to ascertain whether they *were legitimately flood affected and applied the loans to what was originally proposed to the financial institution.* The sample of clients for which spot checks are conducted coincided with the sample of participating bank files verified above. verification, on a sample basis, of reflows of interest and capital repayment by participating financial institutions back to the Project Account held at BCI. Also report on penalties or devolution to the Project Accounts of moneys held by participating banks after a 30-day period.

1.3 Summary of audit results

1.3.1 Fund Accountability Statement

The Fund Accountability Statement does not form part of the terms of reference and hence is excluded from our audit.

1.3.2 *Review of the financial tracking framework:*

1. The financial tracking mechanism in place relies on information being made available by the various participating banks on a monthly basis. The PMU has struggled in obtaining certain vital information such as detailed bank statements required to prepare the monthly reconciliation from several financial institutions. This has caused and is causing considerable delays in reconciling the data contained in the PMU database to that reflected by the respective participating institution bank accounts.
2. Once information is available, the PMU proceeds to prepare a detailed reconciliation and then prepares a credit reconciliation report and an amortization reconciliation report. These reports list various anomalies encountered. Copies are sent the respective banks and USAID.
3. Problems listed by the PMU include amongst others:

Bank	Reconciliation Period	Anomalies detected
BCI	15/01/01 to 13/09/01 01/11/01 to 31/01/02	Discrepancies exist between dates that funds were received by the bank and credit granted to the clients. This has led to penalties being calculated at MZM 1.333.473.000 by the PMU but this amount has not yet been paid.
BCM	1/4/01 to 30/10/01 23/02/01 to 27/8/01	Lack of evidence that amounts were handed over to clients; Lack of repayment details being provided by the bank; Discrepancies between dates reflected in contracts and amortization schedules; Lack of certain contracts and amortization schedules;
BIM Leasing	7/11/01 to 26/11/01 5/5/01 to 2/11/01 01/05/01 to 2/11/01	Interest was not credited on the project account without valid explanations being provided by the bank;
BIM	14/2/01 to 3/12/01 1/7/01 to 30/10/01	The bank retained funds amounting to MZM1.350.000.000 without handing these over to the client nor refunding these to PMU; Interest was not credited to the project account;
BF	25/8/01 to 31/12/01 1/1/01 to 24/8/01	Interest was not credited to the project account;
GAPI	21/8/01 to 6/11/01 1/1/01 to 20/8/01 7/4/01 to 6/11/01	Interest was not credited to the project account; Amortization Schedules were altered without notifying the PMU in advance. Clients that are behind on repayments are not being processed in terms of the agreements entered into with the respective clients;
BCI Leasing	1/1/01 to 20/8/01	Utilization of project funds for a period of 60 days (13/6/01 to 02/08/01) without a valid explanation;
Credicoop	10/7/01 to 20/9/01	Interest was not credited to the project account.

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1.3.3 ***Review, on a sample basis, of participating banks compliance with the terms and conditions stipulated in the Participating Bank Agreement:***

1. The responsibility for obtaining the evidence that the client is a flood effected victim rests with the participating banks. During the course of our audit, and after discussions with the PMU, we noted that the banks did not provide the PMU with any evidence that the client is in fact a flood victim, nor was this required by the PMU.

2. The participating banks are required to submit to the PMU on a monthly basis, information required to perform the reconciliation with the database. From the sample selected, and after discussions with the PMU, we are unable to conclude that the participating banks are complying with this requirement of the respective Participating Bank Agreement.

3. The participating banks are required to provide the PMU with up to date Amortization Schedules that are in accordance with loan agreements. From the sample selected, and after discussions with the PMU, we are unable to conclude that the participating banks are complying with this requirement of the respective Participating Bank Agreement

1.3.4 ***Review, on a sample basis, of the participating banks' clients and the use to which loan proceeds were put:***

1. Loan recipients were not required to open separate bank accounts to control payments for flood recovery purposes. From the sample selected (Annex A), it was not possible to trace payments obtained from loans to specific recovery projects.

2. From the sample selected, certain clients had not yet received the funds due to delays in advancing the funds from the banks side. The explanation provided by the banks is that all requisites have no yet been met.

3. In the agreements signed by USAID, the Government of Mozambique and the respective participating banks, Article 6.4 requires that group companies individually provide for their guarantees. During our audit, we noted various loans granted by BCI are being secured by the same group company. This is in contravention of this article.

1.3.5 ***Preliminary review, on a sample basis, of interest and capital repayments as well as penalties incurred for delays in loan disbursements from participating bank accounts to clients.***

1. The bulk of interest and capital repayments will only be payable in the medium to long term. Subsequent to the period covered by this audit report, from the sample selected and from discussions with PMU management, banks are not keeping adequate control over amortization schedules nor are they keeping up with repayments.

2. Subsequent to the period covered by this audit report, certain participating institutions have altered the amortization schedules unilaterally without informing the PMU of the revised repayment periods.

3. Subsequent to period covered in this audit report, penalties have been calculated by the PMU but have not been paid over by the banks for various.

1.4 Summary of management's comments

FINDING	MANAGEMENT'S COMMENTS
1.3.2.1	Agree. However it should be noted that the situation has improved substantially – as per PMU report 25 February 2002, given to the auditors.
1.3.2.2	Agree.
1.3.2.3	Agree.
1.3.3.1	Agree. This issue was debated at the time of preparation of agreements later signed with the banks. It was concluded that, more than a "signed & stamped paper", the emphasis should be given to (1) the relationship/familiarity bank-client, because the banks are the major key players in this project; and (2) the monitoring of implementation process. Therefore, (1) PMU conferred the loan applicant's eligibility with the banks before submitting loan proposals to the Program Committee; (2) the names of all loan recipients were published in a major local newspaper; and (3) random visits to loan recipients have been undertaken in all provinces. Also note that companies based in places such as.Chokwe and Xai-Xai could not have not been affected by the floods, and hence proof is redundant.
1.3.3.2	Agree. This difficulty has been included in the PMU regular reports, given to the auditors. The situation is now different.
1.3.3.3	Agree. The situation of the Repayment Accounts is similar to that of the Credit Accounts.
1.3.4.1	This was not required in the agreement, as noted. In accordance with the agreement, the financial institutions have to manage the resources and risk. A separate account for loan recipients is surely not the only possible means. It would be interesting to know how the banks are monitoring the use of resources they made available to their clients, and what can be done from now on.
1.3.4.2	Agree. There are different types of cases where the responsibility for delays in disbursing money to clients can be attributed to the banks or to the clients themselves. Although the amount of funds involved is not very important, due to the deadline of loan use (September 2002), and considering that there are loans pending funding (about 85 billion MTS un-funded loans are with the PMU), it is necessary to fix a time limit after which PMU can ask for the cancellation of approved loans without signed credit contracts.
1.3.5.1	Agree.
1.3.5.2	Agree.
1.3.5.3	Agree. In fact, until now PMU has been discussing with the banks the justifications. In few cases justification was accepted, but in other cases PMU is ready to proceed with request for payment. Please also note that in all the minutes of reconciliation, PMU has been reminding banks about the need to proceed with the payment of the penalties.

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2. FUNDS ACCOUNTABILITY STATEMENT

2.1 Findings and recommendations

2.1.1 Introduction

The Funds Accountability Statement does not form part of the terms of reference and hence is excluded from our audit.

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3. INTERNAL CONTROL STRUCTURE

3.1 Independent Auditor's Report on Internal Controls Structure

To the Project Management

ER: ACT Enterprise Credit Activity managed by Deloitte & Touche

Maputo

Mozambique

In accordance with the terms of reference we have performed the following for ER: ACT Enterprise Credit Activity managed by Deloitte & Touche for the period November 1, 2000 to October 31, 2001:

- *a review of the financial tracking framework;*
- *a review, on a sample basis, of participating banks compliance with the terms and conditions stipulated in the Participating Bank Agreement;*
- *a review, on a sample basis, of the participating banks' clients and the use to which loan proceeds were put; and*
- *a preliminary review, on a sample basis, of interest and capital repayments as well as penalties incurred for delays in loan disbursements from participating bank accounts to clients.*

We conducted our audit in accordance with U.S. Government Auditing Standards issued by the Comptroller General of the United States.

The management of ER: ACT Enterprise Credit Activity managed by Deloitte & Touche is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures.

The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that the assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and in accordance with the terms of the agreements.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants (AICPA). We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of Deloitte & Touche / PMU-Program Management Unit in Annex B of this report.

This report is intended for the information of ER: ACT Enterprise Credit Activity managed by Deloitte & Touche and the U.S. Agency for International Development (USAID). However, upon release by USAID, this report is a matter of public record and its distribution is not limited.

Maputo, February 28, 2002

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3.2 Findings

3.2.1 Introduction

The control environment reflects the overall attitude, awareness and actions of management. The accounting system consists of methods and records established to identify, assemble, analyze, classify, record and report transactions. Control procedures are those policies and procedures in addition to the control environment and accounting system that management has established to safeguard the organization's resources.

Our review of the internal control structure was directed towards those significant policies and procedures, which relate to the nature of project funding arrangements.

3.2.2 Findings and recommendations

We noted no matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Public Accountants (AICPA). Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the recipient's ability to record, process, summarize, and report financial data consistent with the assertions of management in respect of the matters set out in our terms of reference above.

Other minor issues have been raised in our management letter under Annex B.

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4. COMPLIANCE WITH TERMS OF AGREEMENT

4.1 Independent auditor's report on compliance with agreement terms and applicable laws and regulations

To the Project Management

ER: ACT Enterprise Credit Activity managed by Deloitte & Touche

Maputo

Mozambique

In accordance with the terms of reference we have performed the following for ER: ACT Enterprise Credit Activity managed by Deloitte & Touche for the period November 1, 2000 to October 31, 2001:

- *a review of the financial tracking framework;*
- *a review, on a sample basis, of participating banks compliance with the terms and conditions stipulated in the Participating Bank Agreement;*
- *a review, on a sample basis, of the participating banks' clients and the use to which loan proceeds were put; and*
- *a preliminary review, on a sample basis, of interest and capital repayments as well as penalties incurred for delays in loan disbursements from participating bank accounts to clients.*

Our audit in accordance with generally accepted auditing standards and US Government Auditing Standards issued by the Comptroller General of the United States.

Compliance with agreement terms and laws and regulations applicable to Deloitte & Touche/PMU is the responsibility of management of ER: ACT Enterprise Credit Activity managed by Deloitte & Touche. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of non-compliance are: failure to follow requirements or violations of agreement terms and laws and regulations that cause us to conclude that the aggregation of misstatements resulting from those failures or violations is material to the PMU's financial tracking mechanism.

We considered the material instances of non-compliance in forming our opinion on the matters set out in our terms of reference above

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Except for the matters set out in 4.2.2 below and the limitations to our scope as set in 1.2.2 above, the results of our tests of compliance indicate that with respect to the items tested, USAID ER: ACT Enterprise Credit Activity managed by Deloitte & Touche complied in all material respects with the provisions referred to in the third paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that USAID ER: ACT Enterprise Credit Activity managed by Deloitte & Touche had not complied, in all material respects, with those provisions.

This report is intended solely for the information of ER: ACT Enterprise Credit Activity managed by Deloitte & Touche and USAID. However, upon acceptance by the USAID Office of the Inspector General, this report is a matter of public record and its distribution is not limited.

Maputo, February 28, 2002

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4.2 Findings and recommendations

4.2.1 Introduction

USAID requires all entities regardless of the country or legal entity, to comply with the terms of conditions included in the ER: ACT Enterprise Credit Activity managed by Deloitte & Touche agreement, attached provisions and referenced procurement regulations. In general, such compliance cannot be waived by a ER: ACT Enterprise Credit Activity managed by Deloitte & Touche or by USAID.

Procedures performed in this audit to test compliance with the agreement and related provisions included:

- a review of ER:ACT Enterprise Credit Activity managed by Deloitte & Touche agreements and related regulations to identify those provisions and regulations which could have a material effect on the financial Tracking Mechanism; and

- audit procedures including detailed testing to evaluate ER: ACT Enterprise Credit Activity managed by Deloitte & Touche's compliance with these provisions and regulations.

4.2.2 *Our Findings and Recommendations are as follows after carrying out the following procedures in accordance with our terms of reference listed in 4.1 above:*

Finding No. 1 - Monthly Reconciliation Reports

The participating banks are required to submit to the PMU on a monthly basis, information required to perform the credit and amortization reconciliation with the database. From the sample selected, and after discussions with the PMU, we are able to conclude that the participating banks are not complying with this requirement of the respective Participating Bank Agreement.

Recommendation No. 1

Strict measures should be enforced to have banks comply with the submission of required information. The credit and amortization credit reconciliation reports need to be performed on a monthly basis.

Management Comments No. 1

PMU has resorted to extreme measures in at least two cases, when disbursements to those banks were suspended. This impacted negatively on the clients and not on the banks. PMU is convinced that keeping the pressure on the banks is resulting more positively than the use of other more formal extreme measures. PMU believes that the pressure on the banks has been the reason for the improvement that has been experienced lately.

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Finding No. 2 - Delays in advancing funds

From the sample selected and as set out in Appendix A certain clients had not yet received the funds due to delays in advancing the funds from the banks side. Penalties have been calculated but not yet levied. The explanation provided by the banks is that all requisites have no yet been met.

Recommendation No. 2

The PMU should determine the validity of the delays in making the money available to clients. Penalties should only be wavered once the participating bank has provided a valid explanation to the PMU.

Management Comments No. 2

Agree. This is an on-going process, explained above.

Finding No. 3 - Article 6.4 of Participating Bank Agreements

In the agreements signed by USAID, the Government of Mozambique and the respective participating banks, Article 6.4 requires that loan recipients belonging to the same groups of companies individually provide for their own guarantee. During our audit, we noted various loans granted by BCI – Banco Comercial de Investimentos are being secured by the same group of companies. This is in contravention of the abovementioned article.

Recommendation No. 3

The PMU should include in its database the entity providing the guarantee for each loan. A listing of duplicate guarantees can then be easily prepared. The banks should then be approached to rectify the contravention of Article 6.4. In order to prevent default on any of these loans, banks could be made fully responsible for unpaid loans.

Management Comments No. 3

Agree.

Finding No. 4- Evidence of Flood Victim Status

The responsibility for obtaining the evidence that the client is a flood effected victim rests with the participating banks. During the course of our audit, and after discussions with the PMU, we noted that the banks did not provide the PMU with any evidence that the client is in fact a flood victim, nor was this requested by the PMU.

Recommendation No. 4

For record purposes, the PMU should keep a copy of whatever evidence the bank has deemed adequate to give the loan recipient flood victim status. This information could then be filed with the other supporting documentation.

Management Comments No. 4

PMU does not want to substitute the banks in their responsibilities, especially halfway the project. However, PMU is willing to notify the banks about this issue requesting them to complete their files.

APPENDIX A SAMPLE SELECTED FOR AUDIT PURPOSES

IMPLEMENTATION. LETTER	BENEFICIARY	AMOUNT APPROVED (MZM)	MADE AVAILABLE AS AT 31.10.2001	BANK
50	MOZRIH METAIS, Lda	2.550.000.000,00	2.550.000.000,00	BCI
54	RSC Moçambique, Lda	1.700.000.000,00	Not yet made available	BCI
54	Socimol, Lda	4.250.000.000,00	Not yet made available	BCM
46	Brithol Michcoma Moçambique	1.700.000.000,00	1.700.000.000,00	BF
51	Constructora do Tâmega	4.250.000.000,00	Not yet made available	BF
54	Maragra Acucar	2.550.000.000,00	Not yet made available	BF
46	Maragra Açucar - Grupo Maragra	1.700.000.000,00	1.700.000.000,00	BF
46	Maragra Comercial - Grupo Maragra	1.700.000.000,00	Not yet made available	BF
54	Maragra SARL	2.550.000.000,00	Not yet made available	BF
46	Maragra SARL – Grupo Maragra	1.700.000.000,00	1.700.000.000,00	BF
46	Pescabom, Lda.	1.700.000.000,00	1.700.000.000,00	BF
40	Pescamar	1.700.000.000,00	1.700.000.000,00	BF
27	Refrigerantes SPAR, Lda	1.700.000.000,00	1.700.000.000,00	BF
54	Coca Cola SABCO Moçambique, Lda	4.250.000.000,00	Not yet made available	BIM
54	Emocil, Lda	4.250.000.000,00	Not yet made available	BIM
48	Açucareira de Moçambique, SARL	4.250.000.000,00	4.250.000.000,00	BIM Leasing
52	Ceta - Construções e Serviços, SARL	4.250.000.000,00	4.250.000.000,00	BIM Leasing
52	CMC estero. Spa	4.250.000.000,00	4.250.000.000,00	BIM Leasing
52	Profuro Internacional, Lda	4.250.000.000,00	4.250.000.000,00	BIM Leasing
52	Companhia Industrial da Matola, SARL	4.250.000.000,00	4.250.000.000,00	BIM Leasing
51	Europa Agências, Lda	4.250.000.000,00	4.250.000.000,00	BIM Leasing
54	Rumdel Construction (Moçambique), Lda	4.250.000.000,00	Not yet made available	BIM Leasing
52	Sulbrita, Lda	4.250.000.000,00	4.250.000.000,00	BIM Leasing
54	Vendap Moçambique, Lda	4.250.000.000,00	Not yet made available	BIM Leasing
31	Enacomo (Sussundenga)	830.000.000,00	830.000.000,00	GAPI
31	Dimac – Xai Xai	1.650.000.000,00	Not yet made available	GAPI
31	MCI (Chimoio)	1.650.000.000,00	Not yet made available	GAPI
31	Agrivet	450.000.000,00	Not yet made available	GAPI
31	UGC – Aviário Tsalala	1.650.000.000,00	1.650.000.000,00	GAPI
31	UGC - Aviários da Liberdade	1.650.000.000,00	1.650.000.000,00	GAPI
26	UGC – Fábrica de Rações/Prodag	1.623.000.000,00	1.623.000.000,00	GAPI
26	UGC – União 9	1.632.000.000,00	1.632.000.000,00	GAPI
	Total Sample Value Selected	**89.335.000.000,00**		

SAMPLE SELECTION	*Number*	*Value (MZM)*
Number of Loans as at 31 October 2001	*241*	*379.607.938.900*
Loans in sample selected above:	*32*	*89.335.000.000*
Percentage of loans selected:	*13.2%*	*21,43%*

The audit was conducted in accordance with the guidelines stipulated in the "Guidelines for financial audits contracted by foreign recipients" as issued by the office of the Inspector General. The following non-material weaknesses were discovered during the performance of our audit procedures.

Weakness No. 1 - Tracking System

Currently the PMU Database is kept in Excel. As Excel does not provide an adequate audit trail for any adjustments made to the database, we feel that it is inadequate to control future repayments and interest obligations by the various banks and their respective clients.

Recommendation No. 1

We recommend that a formal database software program be acquired by the PMU. This will enable the PMU to better safeguard the integrity of data kept on this database.

Management Comments No. 1

PMU considers that the main issue is not the software involved, although it has requested funds to improve the existing digitalized information system.

PMU gives emphasis to two main elements:

- External auditing;
- Bank account reconciliation process.

Loan delivery is an activity that will end by September 2002; loan repayment is an activity that will prolong for five years. Therefore, at the end of the delivery process an external audit should take place to ascertain the amount of money delivered and demonstrate what the amount of repayments should be.

PMU wants to stress that the different databases in use are not accounting systems; their purpose is to monitor and verify the accuracy of the information supplied by the banks. When differences are found, banks are notified through the reconciliation process.

Weakness No. 2 – Amortization Schedules

The bulk of interest and capital repayments will only be payable in the medium to long term. Subsequent to the period covered by this audit report, from the sample selected and from discussions with PMU management, banks are not keeping adequate control over amortization schedules nor are they keeping up with repayments. Subsequent to the period covered by this audit report, certain participating institutions have altered the amortization schedules unilaterally without informing the PMU of the revised repayment periods.

Recommendation No. 2

Final amortization schedules need to be agreed by the PMU and the bank. No further alterations should be permitted without prior consultation with the PMU.

Management Comments No. 2

This recommendation is already included in the draft a new addendum to the existing "Regulamento".

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