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**FINAL REPORT**  
**August 1, 1997 -- March 2, 1998**

**Financial Sector Development Project II**  
**Contract #PCE-Q-00-93-00071-00**  
**Delivery Order #806**

**Assistance to the Cooperative Bank of Uganda**

**Prepared for**

**U S Agency for International Development (USAID)**  
**Kampala, Uganda**  
**and**  
**Peter J Robinson, Managing Director**  
**The Co-operative Bank Limited**

**by**

**George J Smith**

**BA RENTS**  
GROUP LLC

**March 2, 1998**

**Financial Sector Development Project II  
CONTRACT PCE-Q-00-93-00071-00, Delivery Order 806**

**INTRODUCTION**

This final report is being issued under the terms of Contract No PCE-Q-00-93-00071-00, Delivery Order No 806. Recommendations span donor commitment, organizational structure, employee capabilities and ethics. These are the long-term issues that will affect the sustainability of the Cooperative Bank.

Some of the issues addressed in the last quarterly report are repeated here for reference purposes. Also included is an update on activities undertaken during a one-month extension period.

The USAID technical officer has requested recommendations for the future operations of the Bank. The last section of this report is offered as a response to this request. Also, the Managing Director's final report addresses many of the tasks that need to be addressed for 1998.

**THE MANAGEMENT TEAM**

Barents team members have utilized days worked under Delivery Order # 806, through March 2, 1998 as follows:

Name	Position	Date Started	Days Appvd	Days Used	Days Left
George Smith	G M Financial Services	8/1/97	157	157	0
Tom Posa	Automation Specialist	9/6/97	149	149	0
Pam	MISS Advisor	1/11/98	<u>26</u>	<u>25</u>	<u>1</u>
		Total	<u>332</u>	<u>331</u>	<u>1</u>

The advisors have performed their duties and reported their activities in writing as is required by terms of the delivery order. During January 1998, a 30 day, no-cost, contract extension was granted and the delivery order was extended until March 2, 1998. The above table reflects the re-allocated, approved days.

## **PROJECT STATUS**

A number of milestones were attained during the course of the delivery order. For the first time, the Bank has a Strategic Plan through the year 2000. It also has a properly completed Profit Plan for 1998. The structure and the direction for the Bank's turn-around have been established.

In addition, the retirement plan has been restructured into a performance-based plan. This change has resulted in annual savings in operating costs of between 350 million and 500 million shillings. A significant portion of the employees' compensation is now based on the Bank's ability to be profitable.

The capital structure of the Bank was strengthened. USAID will provide two billion shillings of capital to the Bank through the PL 480 program. The employees have made a capital contribution of 1 billion shillings from their former pension reserve. In return, employees will receive a distribution of the Bank's stock. The Bank of Uganda has approved the restructuring of six billion shillings of revaluation capital to share capital in order to reflect the transition to the newly incorporated bank. The result of the capital transactions has improved core capital from a negative 3 billion shillings to a positive 6 billion shillings.

Considerable capacity building has taken place with badly needed training and workshops in the areas of accounting, finance, data processing and credit management.

The milestones that are incomplete are the computerization and the telecommunications programs. These programs were delayed due to the Bank not receiving promised equipment. The delay has set back certain aspects of the turnaround by at least a year.

## **OPERATIONAL ISSUES**

A recent appraisal of the Bank's property reflected a value significantly less than the appraisal value five years ago. Inflation and other economic factors would normally cause property values to rise. However, there is not an active market for property like the Bank's in Kampala, thus, appraisers must calculate a current value on the basis of the future value of rents. Longevity of land leases is a factor.

While the Bank owns the buildings, the land is leased. Extension of the current land lease(s) is expected to add to the calculated value of the property. These lease extensions are critical since the previous appraisal value is the amount used when closing out all of the "Old Bank's" capital to Share Capital and to Core Capital.

If the current valuation remains, it could be necessary to reflect lower property values on the balance sheet, thus reducing the amount of capital. This could also result in a requirement to depreciate the buildings over the remaining life of the lease, rather than the longer period of the building life. Such a change would result in significantly higher amounts of depreciation being charged to operating expense.

The Bank still has not received written approval from the Uganda Revenue Authority to carry over all - or at least a portion of - the "Old Bank's" tax losses. If this approval is granted, and if the external auditors approve of the accounting treatment, it may be possible to recognize some or all of the tax effect (30% of the losses) as assets on the balance sheet. This treatment would also positively affect the value of capital by an equal amount.

As mentioned in previous reports, employee dishonesty and inaccurate record-keeping remain major problems. Poor management and improper staffing are also problems that need to be addressed in the immediate future. Recent events serve to emphasize that corruption and dishonesty are prevalent throughout the Bank, and that only strong and consistent management over several years will correct the problem. This issue is also discussed in the final section of the report.

#### **ACTIVITIES FOR THE 30 DAY EXTENSION PERIOD**

The equipment for the pilot communications project has been installed and only minor problems have been encountered. The primary problem has been with occasional interference of transmissions into Kampala. A higher powered antenna has been ordered and the problem is expected to be corrected.

The Ernst & Young audit is in process. Many additional questions and analysis were required due to the fact that the audit is being performed by E&Y for the first time. Bank personnel have been unable to respond to the requests in a timely fashion, resulting in delays in the auditors' completion of their work. The audit was not completed when the Barents team departed Kampala.

A former advisor has been contracted by the Bank to substitute in the Financial Services area until a long term General Manager of Financial Services can be appointed.

The major issues that remain to be addressed are the revaluation problem mentioned previously and a favorable resolution of the fraud (approximately 800 million shillings) in Iganga. Either issue could have a negative impact on the audited financial results for 1997.

A workshop on the automated accounting system was held to train accounting and treasury personnel in data extraction from the automated system and data analysis

## **RECOMMENDATIONS FOR FUTURE BANK OPERATIONS**

Considerable progress has been made in the restructuring of the Bank. However, a number of important issues must be addressed in order to make it sustainable for the future. The following recommendations are offered for the consideration of USAID and Bank management.

**RECOMMENDATION 1 USAID should make a commitment to engage strong and consistent management for the next four to five years.** If USAID can not commit to technical assistance beyond a two year window, attempts should begin immediately to obtain assistance from other sources for the recommended term.

Technical assistance for the Bank has been engaged on a short-term basis. Short-term milestones have been established for the term of each expatriate team. Often, the management styles of the successive teams have differed. At times, milestones have not conformed to prudent business practices since they have been developed before teams have become familiar with the requirements of their assignments. A four to five-year commitment by USAID or other donor group is necessary to engage strong and consistent expatriate management at the Bank.

One of the initial tasks of the long-term expatriate team should be to expand and update the Strategic Plan to cover the period of technical assistance commitment. The objectives and milestones that are established in the Plan should, then, be the objectives and milestones for the team.

**RECOMMENDATION 2 USAID should look for ways to streamline its provision of personnel and other resources for the bank.** The positive effects of advisors' efforts have sometimes been reduced because of long delays in the receipt of computers and other necessary equipment. Presently, valuable time and momentum have been lost due to delay(s) in receipt of equipment that was expected several months ago.

Erosion of accomplishments also occur when gaps exist between the time that one team departs and another arrives. If a change of advisory personnel is necessary, every effort should be made to insure that a gap in technical assistance are minimized. In addition, some orientation time should be planned into the changeover in order to affect a smooth transition to the new team from the previous one.

**RECOMMENDATION 3** Individuals to fill senior positions should be recruited from outside the Bank. Management skills among the middle and top officers of the Bank are weak. The above recommendation for a four to five year commitment by USAID is congruent with the time required to develop qualified, local managers to fill senior positions.

New management personnel should work within the Bank for a six to twelve-month trial period. If their performance is acceptable, they should be assigned to work for up to a year under an internship program with an American or British bank. The recruits could then return to the Bank in deputy positions to compete for top management positions.

At present there is no one within the Bank capable of filling the position of Managing Director. For the GM-FS position, there is one possible candidate within the Bank, but the individual would have to show a considerable amount of initiative to earn the position.

Corruption and dishonesty are prevalent throughout the Bank, and internal controls are neutralized. The amount of fraud detected is substantial. A network exists within the Bank through which unauthorized payments and loans are made between employees. Other forms of abuse involve collusion between employees and customers.

While it is difficult to identify perpetrators, it is believed that the network begins at the Bank's senior management level and carries down to the lower levels of employees. Other employees who are not directly involved in such actions are aware of what is happening and are considered as complicit by virtue of their silence. There have been a few instances of "whistle blowing" by anonymous employees who have reported dishonest acts, however, these instances are undoubtedly few in comparison to the number of instances that remain unreported.

Over the last year several specific cases of fraud were discovered. Yet, it seems that the alleged perpetrators were prosecuted in only one instance. The advisors were told that suspects used some of the stolen funds to bribe various justice officials in order to avoid incarceration. Also, full restitution of the Bank's losses seldom occurs. Without some form of penalty being imposed on those caught embezzling from the Bank, the incentive to commit such crimes will continue.

**RECOMMENDATION 4** Additional modifications must be made to the organizational structure of the Bank. A senior level position should be established, encompassing the total quality management (TQM), business development, strategic planning and personnel functions. Presently, only marginal success is being achieved in any of these areas.

One individual must be responsible for developing effective personnel policies, customer awareness and ethical standards. Most of the personnel functions such as performance evaluations, career development, merit pay increases and job promotions are being made by the Personnel and Training Committee. None of the individuals on this committee have the requisite experience for performing this function. Many of the committee's decisions are biased, showing little objectivity. And in general, management by committee in these areas is not sound practice. The personnel and training functions should lie under the control of TQM officer, since Total Quality Management concepts involve employee performance in the areas of customer services and provision of services to other employees.

Given the size of the Bank, the TQM officer should also have the responsibility for business development and for strategic planning. This department would, in effect, be responsible for much of the "think tank" type of activity within the Bank. If the performance of the person selected for this position is acceptable, he/she could be considered for the Managing Director's position.

**RECOMMENDATION 5** The Microenterprise Agency (MEA) reporting should be changed. Microenterprise development has been very successful in its initial stages of operation. However, the future success of the MEA will be determined largely by the extent of its integration into the commercial banking system. This will be accomplished largely through changes in organization and reporting structure. In the absence of these, MEA could be a drain on the limited resources of the Coop Bank. Both organizations would become weaker.

At present, each MEA manager reports to a "mother branch" manager of the commercial bank. They also report to the MEA Chief Manager. The lines of reporting responsibility between the two organizations are not clear. The MEA uses the resources of the commercial bank, such as data processing and cash mobilization, but is not charged for such services. The commercial bank does not have a cost accounting system to allocate internal charges or credits, and will not have one for at least another year. Also, the operation of MEA is considerably different from that of a commercial banking enterprise. Certain of the objectives in the MEA contract with the donor organization were developed without consideration for the Bank's ability to provide services to it.

MEA is expected to become a more significant part of the Bank. Additional agencies are planned for the immediate future. Also, plans are being made to downsize some of the present branches to "mini branches" or to MEA agencies. High volume transactions of MEA and the commercial bank's small depositors require an efficient automated system. These efficiencies do not presently exist in most areas of the Bank.

In order to rectify this situation, the following steps are recommended

- ◆ MEA should be incorporated as a wholly owned subsidiary of the Bank. MEA and the commercial bank should be organized as two distinct business units under separate management control. If separate management control is not desired, clearly defined responsibilities of each manager for each business entity should be established. Performance evaluations and compensation should be adjusted accordingly.
- ◆ Separate legal agreements should be executed to provide for pricing of services between the two business units. In effect, cash transfers between entities should be treated as loans/deposits and interest should be paid/charged. The cost of other services such as cash mobilization and technical expertise should also be documented with legal agreements. This recommendation will better enable management to evaluate the financial results of each business unit and facilitate future audits.
- ◆ Growth in future high volume activities should be curtailed until the automation and communication systems can be developed to process transactions in an efficient manner.
- ◆ In recognition of the increasing significance of MEA in overall banking operations, the Chief Manager-MEA should report to the Managing Director. This Manager should serve on the Executive Committee of the Bank.
- ◆ The bank has been receiving assistance from the CAAS Project, Presto and PL480. In order to ensure consistency in policies and contractual arrangements, it would be beneficial if all donor activities are coordinated by one person at USAID, as well as the Managing Director of the Bank.