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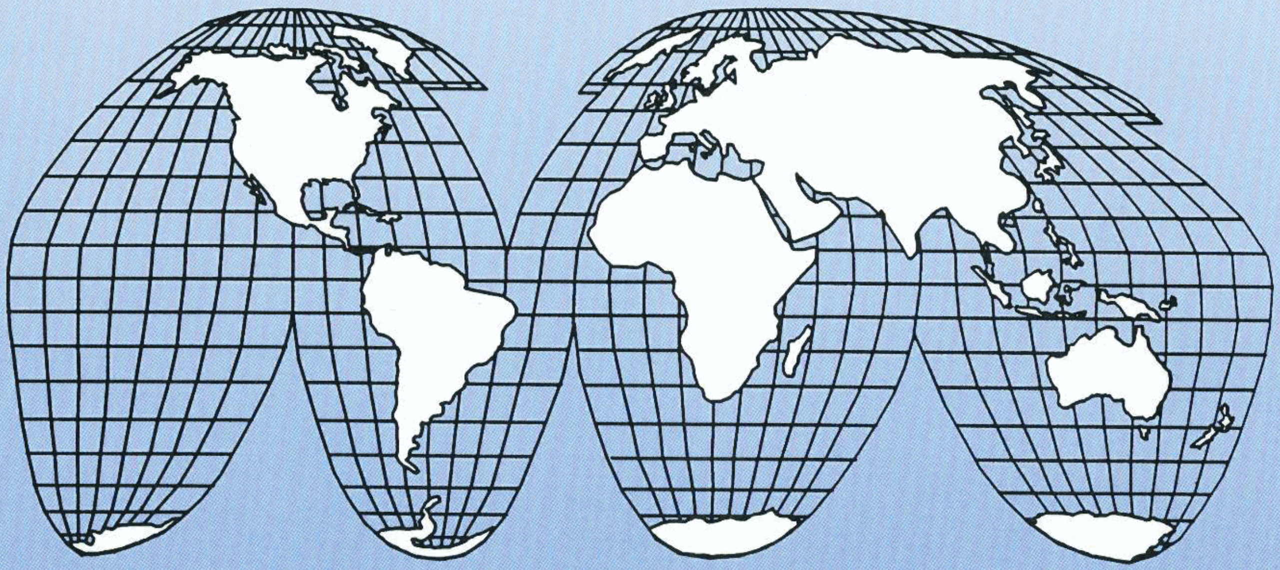
OFFICE OF INSPECTOR GENERAL

Agreed-Upon-Procedures Review of USAID Resources Managed by the Southern Africa Enterprise Development Fund, USAID Grant No. AOT-0515-G-00-5086-00 (Originally Grant No. AOT-G-00-95-00086-00) for the Period November 1, 1995 to September 30, 2003

Audit Report No. 4-690-05-005-N

March 14, 2005



UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID

PRETORIA, SOUTH AFRICA

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USAID
FROM THE AMERICAN PEOPLE

Office of Inspector General

March 14, 2005

MEMORANDUM FOR REGIONAL DIRECTOR, USAID/RCSA, Gerald Cashion

FROM: Regional Inspector General/Pretoria, Jay Rollins

SUBJECT: Agreed-Upon-Procedures Review of USAID Resources Managed by the Southern Africa Enterprise Development Fund, USAID Grant No. AOT-0514-G-00-5086-00 (Originally Grant No. AOT-G-00-95-00086-00) for the Period November 1, 1995 to September 30, 2003 (Report No. 4-690-05-005-N)

This memorandum transmits the subject report prepared by Agency-contracted auditor, KPMG Services (Proprietary) Limited (Johannesburg, South Africa).

The review was performed in accordance with U.S. Comptroller General's Government Auditing Standards. The review had scope limitations that KPMG does not have continuing education and external quality control review programs that fully satisfy the requirements set forth in U.S. Government Auditing Standards. In addition, the general ledger was not available for the period prior to October 1, 1997, the audit trail from the general ledger to supporting documentation was not always clear, and most of the staff that maintained and filed the records in that time frame have left the organization.

On April 3, 1995, the U.S. Agency for International Development entered into Grant Agreement No. AOT-G-00-95-00086-00 (later changed to AOT-0514-G-00-5086-00) with the Southern Africa Enterprise Development Fund (SAEDF) for the purpose of encouraging the creation and expansion of indigenous small and medium sized enterprises in the Southern Africa region. The specific countries covered in the agreement were Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. As of September 30, 2003, USAID had provided $87.6 million in grant funds of a total life of project estimated amount of $108 million.

Because of allegations of funds misuse by the Chief Executive Officer and the lack of acceptable Office of Management and Budget (OMB) Circular A-133 audits for the 2001 and 2002 fiscal years, USAID/RCSA contracted KPMG to perform an agreed-upon-procedures-review for the period November 1, 1995 to September 30, 2003. The review covered $63.9 million in expenditures of USAID funds. The specific objectives of the review included:

- Perform an Agreed-Upon-Procedures Review of the Fund Accountability Statements and report on factual findings related to program revenues received, costs incurred, and commodities/technical assistance directly procured by USAID for the period reviewed.

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- Evaluate and obtain a sufficient understanding of the recipient's internal controls related to the USAID-funded programs, assess control risk, and identify reportable conditions, including material internal control weaknesses. This understanding should include a consideration of the methods an entity uses to process accounting information because such methods influence the design of internal controls.

- Perform detailed tests to determine whether the recipient complied, in all material respects, with agreement terms and applicable laws and regulations related to USAID-funded programs. All material instances of non-compliance and all indications of illegal acts should be identified. Special emphasis should be placed on the investment portfolio. Any investments that do not comply with agreement terms should be reported as findings in the report and shown as questioned costs.

- Determine if the recipient has taken adequate corrective action on prior audit report recommendations.

The work conducted by KPMG constituted an agreed-upon procedures review rather than an audit. Consequently, KPMG did not express an opinion on SAEDF's Fund Accountability Statements. However, the review disclosed the following findings:

- **Total questioned costs of $9.6 million ($1.2 million ineligible and $8.4 million unsupported).**

  Operating and investing expenditures were questioned because the auditors deemed them to be unallowable or unreasonably excessive. Unsupported costs consisted principally of employee compensation and benefits, business, administrative, professional, and restructuring costs that lacked supporting documentation or authorization.

  Although not included as questioned costs in Recommendation No. 2 of this memorandum due to a lack of clarity in the grant agreement regarding the requirements for initiating and monitoring investments, KPMG's report questioned $22.4 million of investments for not complying with the USAID grant agreement and/or SAEDF's policies. As reported by KPMG, these questioned amounts were mainly attributable to investments exceeding the credit limits or ineffective monitoring of investments. In addition, certain investments were questioned for lack of, or poor, due diligence. As a result, large sums of money have been lost to SAEDF, and it has not achieved the objectives for which it was set up. For example, during the period audited SAEDF invested $44.2 million of USAID funds into various enterprises in southern Africa. As of September 30, 2003, after write-offs and provisions on remaining investments, the value of SAEDF's entire investment portfolio was only $15.7 million, reflecting a loss of at least $28.5 million. According to paragraph G of Modification No. 06 to the USAID grant agreement, the success of the Fund was to be judged on the extent to which the Fund, over the long term, was able to develop an investment portfolio whose value was at least equal to the amount of funding provided to SAEDF for investment purposes. This objective has clearly not been met.

- **Twenty-six reportable internal control weaknesses, fourteen of which were material.**

  The fourteen material weaknesses included:

  1) Arbitrary appointment of employees.

  2) Poor operation of travel policies and procedures.

  3) Incomplete policies and procedures regarding human resources.

  4) Faxes sent to the Bank instructing the transfer of funds, without requiring the Bank to confirm with a senior SAEDF official.

  5) No disaster recovery plan, and backups of computer data not stored off-site.

  6) Incomplete personnel documentation.

  7) Improper method of accounting for investments.

  8) Lack of adherence to existing policies and procedures with regard to procurement and authorization of expenditures in general.

  9) Deficiencies in performing bank reconciliations.

  10) Conflicts of interest.

  11) Lack of adequate maintenance of investment records.

  12) Lack of adequate due diligence processes.

  13) Lack of effective monitoring of investments.

  14) Disbursements exceeding investment limits.

- **Thirty instances of material noncompliance.**

  1) Non-compliance with OMB Circular A-122 relating to properly authorized timekeeping records.

  2) Non-compliance with SAEDF policies and procedures relating to salary increases and bonuses not linked to performance.

  3) Non-compliance with the Grant Agreement and OMB Circular A-122 relating to CEO benefits.

4) Non-compliance with Section B, point 3.2 of the approved SAEDF human resource (HR) policy manual relating to performance appraisals and bonuses.

5) Non-compliance with the SAEDF policies and procedures manual for the completion of purchase orders.

6) Non-compliance with the SAEDF policies and procedures manual for the procurement process, namely approval limits and the quotation process.

7) Non-compliance with the Grant Agreement regarding conflict of interest experienced by directors of the grantee.

8) Non-compliance with paragraph 10 (travel expenses) of the SAEDF policies and procedures manual.

9) Non-compliance with paragraph 11 (meals and entertainment) of the SAEDF policies and procedures manual, paragraph 12 (Changes in Corporate Structure and Policies) of the Grant Agreement and Modification No. 4 of the Grant Agreement relating to unallowable expenditure.

10) Non-compliance with the Grant Agreement in that all necessary documentation could not be presented by SAEDF management and there was not an adequate audit trail.

11) Non-compliance with the SAEDF HR policy manual with regard to the termination of employees.

12) Non-compliance with the Grant Agreement as the Annual Financial Statements were not issued by January 31 of the following year.

13) Non-compliance with the SAEDF HR policy manual as a performance management process was not in place.

14) Non-compliance with the SAEDF policies and procedures manual regarding the authorization of expenditures.

15) Non-compliance with SAEDF's accounting manual regarding bank reconciliations.

16) Non-compliance with OMB Circular A-122 requiring costs to be reasonable and kept to the minimum relating to telephone and security costs.

17) Non-compliance with OMB Circular A-122 relating to a prohibition on promotional and advertising costs.

18) Non-compliance with the Grant Agreement relating to submitting SF-272 "Federal Cash Transactions Reports".

19) Non-compliance with OMB Circular A-122 relating to reasonable recruitment costs.

20) Non-compliance with OMB Circular A-122 relating to training costs.

21) Non-compliance with the Grant Agreement regarding program income.

22) Non-compliance with the Grant Agreement relating to approval of investments.

23) Non-compliance with the Grant Agreement relating to investments limits.

24) Non-compliance with the Grant Agreement relating to inappropriate target groups.

25) Non-compliance with the Grant Agreement relating to the maintenance of records.

26) Non-compliance with the Grant Agreement relating to performance of due diligence.

27) Non-compliance with the Grant Agreement relating to effective monitoring of investments.

28) Non-compliance with the Grant Agreement relating to redemption of shares.

29) Non-compliance with the Grant Agreement relating to the spirit of the Grant Agreement.

30) Non-compliance with the Grant Agreement relating to an investment outside the target area.

Therefore, we are making the following recommendations:

Recommendation No. 1: We recommend that USAID/RCSA determine the allowability of $9,338,035 in questioned operating activities costs ($944,669 ineligible and $8,393,366 unsupported) detailed in Appendix 1, except for the costs detailed in finding 1.24 in appendix 3 on pages 64-66, of the KPMG report, and recover from the Southern Africa Enterprise Development Fund any amounts determined to be unallowable.

Recommendation No. 2: We recommend that USAID/RCSA determine the allowability of $248,503 in questioned ineligible investing activities costs detailed on pages 77 and 121-122 in Appendix 3 of the KPMG report, and recover from the Southern Africa Enterprise Development Fund any amounts determined to be unallowable.

Recommendation No. 3: We recommend that USAID/RCSA ensure that the Southern Africa Enterprise Development Fund corrects the twenty-six reportable internal control weaknesses detailed in Appendix 2 of the KPMG report.

Recommendation No. 4: We recommend that USAID/RCSA ensure that the Southern Africa Enterprise Development Fund corrects the thirty instances of material noncompliance detailed in Appendix 3 of the KPMG report.

<u>Recommendation No. 5:</u> We recommend that USAID/RCSA not release the remaining Life-of-Grant funds of $20,436,288 to the Southern Africa Enterprise Development Fund until all the internal control and compliance issues detailed in Appendices 2 and 3 of the KPMG report are corrected.

In accordance with Automated Directives System (ADS) 595.3.1.1.a and 595.3.1.5.a, an audit recommendation without management decision may be elevated three months after issuance. Contract, Grant, or Agreement Officers make management decisions on questioned costs and procedural audit recommendations resulting from Office of Inspector General (OIG) desk reviews of financial audits of contractors and grantees. Mission Directors make management decisions for audit recommendations pertaining to Strategic Objective Grant Agreements that he/she signs. Please have the responsible official provide RIG/Pretoria with management decisions for the recommendation(s) presented in this memorandum within three months.

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Report on agreed upon procedures engagement of Southern Africa Enterprise Development Fund for the period November 1995 to September 30, 2003

February 2005

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1 Introduction

1.1 Background section

1.1.1 Introduction to Southern Africa Enterprise Development Fund (SAEDF)

SAEDF is a U.S. not-for-profit corporation organized and existing under the laws of the State of Delaware and operating in Gauteng, South Africa, funded completely by USAID. Revenues generated by the Fund are to be utilized to pay the expenses of the Fund and for reinvestment in new projects and activities in Southern Africa.

Payments to the Fund are made by the USAID Office of Financial Management, Cash Management and Payment Division (M/FM/CMPD), Washington, DC 20523-0209, under a Letter of Credit (LOC) in accordance with the terms and conditions of the LOC and any instructions issued by M/FM/CMPD. Grant funds are available for draw down by the Fund based on estimates set forth in monthly forecasts of cash needs for the following month. SAEDF may hold funds disbursed to it by USAID in interest-bearing accounts prior to the expenditure of such funds for program purposes, and may retain for program purposes any interest earned on such deposits without returning such interest to the Treasury of the United States.

SAEDF activities include transactions to provide financial resources and services through the investment of risk capital in profitable opportunities throughout Southern Africa. The target group is indigenous emerging enterprises, including small and medium firms, which are located and operating in the region. "Emerging" enterprises are those which are pursuing new business ventures or the expansion of existing businesses and which are disadvantaged by their inability to attract long-term capital investment from existing commercial sources in amounts adequate to meet their needs, due to their size, experience or other factors. SAEDF is to invest only in indigenous firms, in which one or more individual citizens of a country in the region both have significant ownership interests and influence over strategic direction and operational control. As a long-term objective, SAEDF will seek to hold minority ownership positions in the firms in which it invests. However, SAEDF may take majority ownership positions in such firms if, in the exercise of its business judgment, it determines that it would be prudent to do so.

1.1.2 Description of USAID program

On April 3, 1995, the U.S. Agency for International Development (USAID) entered into a Grant agreement (AOT-0514-G-00-5086-00, originally AOT-G-00-95-00086-00) with the Southern Africa Enterprise Development Fund (SAEDF), for the purpose of encouraging the creation and expansion of indigenous small and medium-sized enterprises in the Southern Africa region, specifically, Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. Pre-award expenses incurred beginning October 1, 1994, were allowed to be reimbursed under the Grant. As at September 30, 2003 USAID has committed $87,563,712 in grant funds of a total life of project-estimated amount of $108,000,000.

The draw down for the period October 1, 1997 to September 30, 2003 was $59,751,974.

	Investments	Operational	Total
Total draw-downs from October 1, 1997 to September 30, 2003	$54,121,436	$5,630,538	$59,751,974

Certain of the investments have been sold and approximately 40% of the investments have been written off or provided for. The following write-offs and provisions were made:

- Capital losses on equity written-off;
- Capital losses on loans written off; and
- Provision on investment and market value adjustments.

The value of these investments as at September 30, 2003, according to management's best estimate after write-offs and provisions on remaining investments, is $15,660,085.

1.1.3 Program objectives

These funds were to have been utilised for:

- The investment of risk capital in profitable opportunities throughout Southern Africa.
- Technical assistance to directly support SAEDF investments and potential investments.
- Policy reform.

Modification No. 06 dated October 16, 1998 to the Grant Agreement states "The revenues generated by the Fund will be utilized to pay the expenses of the Fund and for reinvestment in new projects and activities in Southern Africa". This same modification also states that the success of the Fund will be judged based on the extent to which the Fund (inter alia):

- Is able to meet it's annual operating expenses from investment reflows and non-US Government sources of income by the estimated completion date of this agreement;
- Over the long term is able to develop an investment portfolio whose inflation-adjusted value is at least equal to the amount of funding provided to the Fund for investment under this agreement.

1.1.4 Period covered

Our review covers the following periods in the relevant areas:

- Fund accountability statement – years ended September 30, 1998, 1999, 2000, 2001, 2002 and 2003.
- Internal control structure – years ended September 30, 1998, 1999, 2000, 2001, 2002 and 2003.
- Compliance with Grant agreement terms and applicable laws and regulations – years ended September 30, 1998, 1999, 2000, 2001, 2002 and 2003.
- Program income (as a separate review) – From inception of Fund to September 30, 1997.
- Status of prior year audit recommendations – years ended September 30, 1998, 1999, 2000, 2001, 2002 and 2003.
- Follow-up of first KPMG internal audit report – period ended September 30, 2003.

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1.2 The agreed-upon procedures engagement

1.2.1 Terms of reference

KPMG South Africa has been contracted by USAID (Contract No 690-C-00-03-00263) to conduct an agreed upon procedures engagement of USAID resources managed by SAEDF under Grant No. AOT-0514-G-00-5086-00 (originally AOT-G-00-95-00086-00). The engagement has been performed in accordance with US Government Auditing Standards and includes such tests of accounting records as specified in the contract.

1.2.2 Agreed-upon procedures engagement objectives and scope

1.2.2.1 Agreed Upon Procedures of USAID Funds

An agreed-upon procedures engagement of the funds provided by USAID shall be performed in accordance with U.S. *Government Auditing Standards* and the Guidelines for Financial Audits Contracted by Foreign Recipients, and accordingly include such tests of the accounting records as deemed necessary under the circumstances. The specific objectives of the engagement on the USAID funds are to:

- Carry out an Agreed-upon Procedures engagement of the Fund Accountability Statements and report on factual findings related to program revenues received, costs incurred, and commodities/technical assistance directly procured by USAID for the period reviewed.
- Evaluate and obtain a sufficient understanding of the recipient's internal controls related to the USAID-funded programs, assess control risk, and identify reportable conditions, including material internal control weaknesses. This understanding should include a consideration of the methods an entity uses to process accounting information because such methods influence the design of internal controls.
- Perform detailed tests to determine whether the recipient complied, in all material respects with agreement terms and applicable laws and regulations related to USAID-funded programs. All material instances of non-compliance and all indications of illegal acts should be identified. Special emphasis should be placed on the investment portfolio. Any investments that do not comply with the Agreement terms should be reported as findings in the report and shown as questioned costs.
- Perform a review of Program income from inception to September 30, 2003. The Program income is to be used to further program objectives and shall be subject to the terms and conditions as funds provided under the Grant. This includes both interest earned on any funds received from USAID, or on any other Program Income, prior to their expenditure; and income earned by the Grantee on any

activities financed by USAID or financed from Program Income, including loan repayments, proceeds from the sale of equity investments, fee income and other cash reflows. It should be noted that Modification number four (4), dated August 14, 1997, permitted SAEDF to use Program Income to cover unallowable costs, as defined by OMB Circular A-122, provided that the Fund's corporate and accounting policies were modified to cover such costs and approved by the Board.

- Determine if the recipient has taken adequate corrective action on audit report recommendations for the years 1998 to 2003.
- Determine if the issues presented in the first KPMG Internal Audit report in January 2003 are valid. All such issues determined to be valid should be reported as findings in the report and shown as questioned costs in the Fund Accountability Statement, if appropriate.

The auditor should design review steps and procedures in accordance with U.S. *Government Auditing Standards,* Chapter 4, to provide reasonable assurance of detecting situations or transactions in which irregularities or illegal acts have occurred or are likely to have occurred. If such evidence exists, the auditor should contact the USAID Regional Inspector General (RIG) and should exercise due professional care with confidentiality and in pursuing indications of possible irregularities and illegal acts so as not to interfere with evidence, potential future investigations, or legal proceedings.

1.2.3 Agreed-upon procedures performed

The principal procedures performed were:

- A review of the terms and conditions of the grant, applicable standard provisions and regulations and other documents as deemed necessary;
- A review SAEDF's internal control structure in order to assess the organisation's significant internal control policies and procedures relevant to the project, and the adequacy of its accounting system and internal controls;
- Review of SAEDF's compliance with Grant agreement terms and applicable laws and regulations;
- Performance of review procedures to obtain reasonable assurance of detecting errors, irregularities and illegal acts, as defined by American Institute of Certified Public Accountant (AICPA) statement of Auditing Standards 53 and 54;
- Testing of disbursement transactions from the Fund Accountability Statements for the years 1998 to 2003 to determine the extent of non-compliance, unallowable or unallocable expenses;
- Follow up external audit recommendations for the years 1998 to 2002;

- Follow up on issues raised in the first KPMG internal audit report issued in January 2003;
- Testing of program income from the Grant's inception to September 30, 2003.

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1.2.4 Scope limitations

1.2.4.1 Other matters

- The general ledger was not available for the period prior to October 1, 1997 (i.e. November 1995 to September 30, 1997). The general ledger for this prior period was apparently maintained by Deloitte & Touche, but neither that firm nor SAEDF are able to locate it. As a result of this, we were not able to review the recording of the Fund's income for this period, or agree the bank reconciliations to the bank balance in the general ledger. It is thus not possible to access the completeness or accuracy of income reported in the Fund Accountability Statement for this period. SAEDF has also not maintained proper books of account for this period, as required by generally accepted accounting standards.
- The audit trail from the general ledger to supporting documentation is not always clear, and most of the staff that maintained and filed the records in the prior years, have left. Staff initially assigned to assist us, were not able to resolve our queries. In these cases the costs were also reported as questioned unsupported costs. At a later stage the former financial manager was assigned to assist us and he indicated that some of our queries could be resolved. Issues that remained unresolved at the close of our initial audit on February 13, 2004 were left reported as questioned, unsupported costs in our first draft of this report. Following additional audit work done by us as required by modification 2 of the contract we have eliminated reporting where we have received acceptable audit evidence.

1.2.4.2 U.S. Government Auditing Standards

KPMG South Africa did not have a continuing education program that fully satisfies the requirement set forth in chapter 3, paragraph 3.6 of U.S. Government Auditing Standards. KPMG South Africa did not have an external quality control review by an unaffiliated audit organisation as required by Chapter 3, paragraph 3.45 of U.S Government Auditing Standards. These matters are included in the reports on the fund accountability, internal controls, compliance, program income, prior year recommendations and issues raised in the KPMG report issued in January 2003.

We believe that the effect of these departures from US Government Auditing Standards are not material. KPMG South Africa has a mandatory quality control review program whereby all assurance partners are subject to review once every three years by an independent partner from another office. This review is done in conjunction with the South African Institute of Chartered Accountants (SAICA), which sends it's own review team to work with our team. Partners and managers in KPMG South Africa are required to attend technical updates and achieve Continuing Professional Education (CPE) hours, which are in excess of those prescribed by SAICA.

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In addition, we participate in KPMG's mandatory worldwide internal quality control review program, which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from our affiliate offices.

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2 Summary of agreed-upon procedures results

2.1 Fund accountability statement and questioned costs

Our reports on the fund accountability statements are presented in Section 3.1 and Appendix 1.

USAID's funding under this grant has been on a 'cost-reimbursement' basis. Between October 1, 1997 and September 30, 2003 a total of $59,751,974 had been drawn down. Total questioned costs for the periods reviewed by us, are as follows:

Total	Ineligible	Unsupported
$32,046,481	$23,653,115	$8,393,366

Note: Before our examination of additional documentation and explanations provided by SAEDF, which were not available at the time of our agreed upon procedures review, the questioned costs were as follows:

Total	Ineligible	Unsupported
$48,711,526	$39,757,429	$8,954,097

Total questioned costs of $32,046,481 should be seen in the light of total drawn-funds of US$59,751,974. The questioned costs are 54% of total drawn-down funds. 74% of the questioned costs relate to ineligible costs, and 26% to unsupported costs.

The major portion ($23,631,246) of **ineligible costs** relate to investments. Investments are questioned on a number of grounds of non-compliance to the USAID/SAEDF Grant Agreement.

Investments have also been questioned on the grounds of not complying with SAEDF's own policies and procedures and best business practice, as well as negligence by investment officers.

In summary, the evidence points to some investments being made that were ill considered in the first place, or not followed up and monitored at later stages. Investment staff may not have been suitably qualified and proficient in this work.

The result of the issues identified with regard to investments, is that large sums of money have been lost to SAEDF, and it has not achieved the objectives for which it was set up (see 1.1.2).

The **unsupported costs** consist of employee compensation and benefits, business, administrative, professional and restructuring (employee termination) costs that lacked supporting documentation or the authorisation procedures as set out in the policies and procedures manual. Staff either ignored, or were unaware of their own policies and procedures. It also appears that there was little attempt amongst staff, management or directors to curb spending so as to make the maximum amount available for investment in the target sector. Unsupported costs are also as a result of the requirements of OMB Circular A-122 regarding salary expense not being complied with.

2.2 Internal control structure

We reviewed SAEDF's overall internal control structure and its operation relevant to the recording of receipts and disbursements under the grant and present our report in Section 4.1 and Appendix 2. Our review indicated deficient design of internal controls as well as failure to observe documented internal controls. We identified 26 reportable conditions, of which 14 were material weaknesses.

The following main deficiencies in the **design** of internal controls were observed:

- Deficiencies in the design of Human Resources and Travel policies.
- CEO's having a significant amount of authority.
- Monitoring of budgets inadequate.
- No bond registered over the movable assets of an investment.
- Lack of effective monitoring.

The following main deficiencies were evident in the **operation** of internal controls:

- Poor operation of travel policies and procedures.
- Incomplete policies and procedures regarding human resources.
- No disaster recovery plan and backups of computer data not stored off-site.
- Personnel documentation incomplete.
- SF-272s not being completed timeously.
- The Equity method of accounting for recording investments was not used.

- Lack of adherence to existing policies and procedures with regard to procurement and authorization of expenditures in general.
- Deficiencies in performing bank reconciliations.
- A large number of journal entries were unnecessarily processed due to misallocations or incorrect or accurate details.
- Conflicts of interests in investments.
- Lack of adequate maintenance of investment records.
- Delays in the approval and disbursements of funds to investments.
- Lack of adequate due diligence processes.

Recommendations relating to internal controls have been made in the detailed findings in Appendix 2.

2.3 Compliance with agreement terms and applicable laws and regulations

The report on compliance with the agreement terms and applicable laws and regulations is set out in Section 5.1 and Appendix 3. There are 30 instances of material non-compliance with the terms of the Grant agreement and USAID regulations.

The main areas of failure in compliance relate to:

- Non-compliance with the Grant Agreement relating to investments.
- Non-compliance with OMB Circular A-122 relating to proper authorised timekeeping records.
- Non-compliance with SAEDF policies and procedures relating to salary increases and bonuses not linked to performance.
- Non-compliance with OMB Circular A-122 requiring costs to be reasonable and kept to the minimum. This relates to professional and legal fees as well as travel and entertainment and telephone costs.
- Non-compliance with OMB Circular A-122 relating to a prohibition on the cost of promotional items.
- Non-compliance with OMB Circular A-122 relating to reasonable recruitment costs within a well-managed recruitment program.

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Non-compliance as above results in significant questioned costs being reported under paragraph 2.1, Fund Accountability Statement.

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2.4 Program income

The report on program income is presented in Section 6.1.

The main findings relate to:

- Deficiencies in performing bank reconciliations.
- General ledger missing for the period from inception to October 1, 1997.

These matters are reported under compliance in 2.3 above. In summary, they result in an inability to effectively audit program income for the affected periods.

2.5 Status of prior year audit recommendations

Our report on the status of audit recommendations for the years 1998 to 2002 is presented in Section 7.1 and Appendix 4.

In summary, only 1 out of 9 recommendations by the **external auditors** for the period 1998 to 2002 has been implemented.

The agreed upon procedures review objectives pertaining to the status of prior years audit recommendations required us to follow up on prior audit recommendations for the years 1998 to 2003. However, at the time of our review, the 2003 audit had not been performed. As a result we are only able to follow up on prior audit recommendations for the years 1998 to 2002.

2.6 Matters raised in the first KPMG report issued in January 2003

The results of our follow up of the first special internal audit report issued by KPMG in January 2003 have been issued as a separate report to RIG/Pretoria.

2.7 Comments from management

The review of SAEDF by KPMG was conducted as per the contract signed between KPMG and USAID.

As agreed at the opening conference between USAID, SAEDF and KPMG, SAEDF management would have the opportunity to respond to KPMG's reported findings during the review.

Management's comments are shown under the relevant section of this report and management comments are also shown verbatim in Appendix 5 of this report.

3 Fund Accountability Statement

3.1 Independent Auditor's Report

The Chief Executive Officer
Southern Africa Enterprise Development Fund
Johannesburg

Scope

We have performed the procedures agreed with USAID in the scope of work as contained in Contract number 609-C-00-03-00263, on the attached Fund Accountability Statement of Southern Africa Enterprise Development Funds (SAEDF) for the years ended September 30, 1998 to 2003, which we have initialled for identification purposes. Except for not having a fully satisfactory continuing education program and not conducting an external quality control review, our engagement was undertaken in accordance with US Government Auditing Standards issued by the Comptroller General of the United States applicable to agreed-upon procedures.

We believe that the effect of these departures from US Government Auditing Standards are not material because we participate in KPMG South Africa and KPMG International's worldwide internal quality review program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from our affiliate offices. Partners and managers in KPMG South Africa are required to attend technical updates and achieve Continuing Professional Education (CPE) hours, which are in excess of those prescribed by SAICA.

The responsibility for determining the adequacy or otherwise of the procedures agreed to be performed is that of USAID. Our procedures were performed solely to assist you in determining the validity of expenditure, completeness of income and use of program income in the Fund Accountability Statement for those years. The procedures are summarised as follows:

- We selected at least 50% of the cost transactions of the Fund for those years, and tested for the following:
  - Supported by valid documentation
  - Approved in terms of the SAEDF's policies and procedures
  - Reasonable and in terms of the USAID Grant Agreement and relevant USAID regulations
  - Properly recorded in the general and program ledgers
- We selected at least 50% of Fund revenue transactions and tested as follows:
  - Proper control of funds in bank accounts or financial institutions

- Proper advances of funds in terms of the USAID Grant Agreement and relevant regulations
- Proper use of reflow funds in terms of USAID regulations.

Findings

Our detailed findings are shown on the Fund Accountability Statement in Appendix 1, and the supporting notes, to which the reader is referred.

USAID's funding under this grant has been on a 'cost-reimbursement' basis. As at September 30, 2003 a total of $59,751,974 had been drawn down. Total questioned costs for the periods reviewed by us, are as follows:

	Total	**Ineligible**	**Unsupported**
Professional Services	$691,822	$206,555	$485,267
Employee compensation and benefits	$7,168,681	$472,068	$6,696,613
Business expenses	$1,059,326	$111,541	$947,785
Administration and other	$343,794	$84,151	$259,643
Restructuring costs	$151,612	$147,554	$4,058
Investments	$22,631,246	$22,631,246	0
	$32,046,481	$23,653,115	$8,393,366

Note: Before our examination of additional documentation and explanations provide by SAEDF, which were not available at the time of our agreed upon procedures review, the questioned costs were as follows:

Total	**Ineligible**	**Unsupported**
$48,711,526	$39,757,429	$8,954,097

The major portion ($22,631,246) of **ineligible costs** relate to investments. Investments are questioned on a number of grounds of non-compliance to the USAID/SAEDF Grant Agreement, i.e.

- Lack of Board approval

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- Lack of indigenous participation in the investee company
- Lack of effective monitoring of investments
- Director conflicts of interest

Investments have also been questioned on the grounds of not complying with SAEDF's own policies and procedures and best business practice as well as negligence by investment officers, in the following areas:

- Inadequate due diligence reviews performed
- Exceeding the limits allowed for individual investments ($1 million)

In summary, the evidence indicates investments being made that were ill considered in the first place, or not followed up and monitored at later stages. Investment staff may not have been suitably qualified and proficient in this work.

The result of the issues identified with regard to investments, is that large sums of money have been lost to SAEDF, and it has not achieved the objectives for which it was set up (see 1.1.2).

The major part of the **unsupported costs** relate to:

- $2.4 million in employee compensation and benefits, business, administrative, professional and restructuring (employee termination) costs that we found to be unsupported. It is thus also not possible to determine whether these costs are justified or not. Some appear to be excessive and even wasteful.
- $6.2 million relate to employee timekeeping. The requirements of OMB Circular A-122 regarding activity reports supporting payroll and employee attendance registers and timesheets were not adhered to.

Because the procedures do not constitute an audit made in accordance with U S Government Auditing Standards, we do not express any assurance on the Fund Accountability Statement for the years ended September 30, 1998, 1999, 2000, 2001, 2002 and 2003.

Had we performed additional procedures other matters may have come to our attention that would have been reported to you.

This report is intended for the information of SAEDF 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. This report relates to the Fund Accountability Statement only, and does not extend to any general-purpose financial statements of SAEDF taken as a whole.

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29 February 2004
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4 Internal Controls

4.1 Independent Auditor's Report

The Chief Executive Officer
Southern Africa Enterprise Development Fund
Johannesburg

Scope

We have conducted an agreed-upon procedures engagement on the fund accountability statement of Southern Africa Enterprise Development Fund (SAEDF) as of and for the period ended September 30, 1998 to 2003. Except for not having a fully satisfactory continuing education program and not conducting an external quality control review, our engagement was undertaken in accordance with US Government Auditing Standards issued by the Comptroller General of the United States applicable to agreed-upon procedures.

We believe that the effect of these departures from US Government Auditing Standards are not material because we participate in KPMG South Africa and KPMG International's worldwide internal quality review program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from our affiliate offices. Partners and managers in KPMG South Africa are required to attend technical updates and achieve Continuing Professional Education (CPE) hours, which are in excess of those prescribed by SAICA.

The management of SAEDF is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the assets are safeguarded against loss from unauthorised use or disposition; transactions are executed in accordance with management's authorisation and in accordance with the terms of the agreements; and transactions are recorded properly to permit the preparation of the fund accountability statement in conformity with the basis of accounting adopted. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

While undertaking our agreed-upon procedures engagement of the fund accountability statement of SAEDF for the above years, we obtained an understanding of internal control. With respect to internal control, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of our agreed-upon procedures review of the fund accountability statement and not to provide an opinion on internal control. Accordingly, we do not express such an opinion.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants (AICPA). Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the recipient's ability to record, process, summarise, and report financial data consistent with the assertions of management in the fund accountability statement.

Our detailed findings in respect of **reportable conditions** are shown in Appendix 2 and the supporting notes, to which the reader is referred. Of the 26 **reportable conditions,** the following 12 are considered to be non-material weaknesses:

1. Human Resources policies do not indicate that bonuses need to be approved by senior officials of the organisation. (Page 3);

2. CEO's having a significant amount of authority. (Page 5);

3. Monitoring of budgets inadequate. (Page 7);

4. A large number of journal entries were unnecessarily processed due to misallocations or incorrect or accurate details. (Page 11);

5. Poor monitoring of telephone costs. (Page 13);

6. Personnel documentation incomplete and lack of management review of timekeeping. (Page 16);

7. Certain CEO benefits that were considered to be "unreasonable". (Page 20);

8. No bond registered over the movable assets for Ahanang Construction CC. (Page 22);

9. Foreign exchange difference on redemption of an investment in Kingdom Securities Holding Limited. (Page 24);

10. SF-272s not being completed timeously. (Page 26);

11. Delays in the approval and disbursements of funds. (Page 28);

12. Non-compliance with policies and procedures regarding authorisation of bank transfer letters and cheques (Page 30).

A material weakness is a reportable condition in which the design or operation of one or more of the internal control elements does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the fund accountability statement may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not be necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not be necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above.

Our detailed findings in respect of **material weaknesses** are also shown in Appendix 2 and the supporting notes, to which the reader is referred. The following 14 **material weaknesses** are reported:

1. Arbitrary appointment of employees. (Page 32);
2. Poor operation of travel policies and procedures. (Page 34);
3. Incomplete policies and procedures regarding human resources. (Page 39);
4. Faxes were sent to the Bank instructing the transfer of funds, without requiring the Bank to confirm with a senior SAEDF official. This risky practice has led to fraud in the South African banking system for other local businesses, as it is easy to send fictitious faxes. (Page 41);
5. No disaster recovery plan, and backups of computer data not stored off-site. This could lead to loss of all financial data, and is an unacceptably high business risk. (Page 43);
6. Personnel documentation incomplete. (Page 45);
7. The Equity method of accounting for recording investments was not used. (Page 47);
8. Lack of adherence to existing policies and procedures with regard to procurement and authorization of expenditures in general. (Page 48);
9. Deficiencies in performing bank reconciliations. (Page 54);
10. Conflicts of interests. (Page 56);
11. Lack of adequate maintenance of investment records. (Page 58);
12. Lack of adequate due diligence processes. (Page 60);
13. Lack of effective monitoring of investments. (Page 62); and

14. Disbursements exceeding investment limits. (Page 65).

Internal control weaknesses are shown in Appendix 2.

This report is intended for the information of SAEDF 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.

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5 Compliance

5.1 Independent Auditor's report on compliance

The Chief Executive Officer

Southern Africa Enterprise Development Fund

Johannesburg

Scope

We have conducted an agreed-upon procedures engagement on the fund accountability statement of *SAEDF* as of and for the years ended September 30, 1998, 1999, 2000, 2001, 2002 and 2003. Except for not having a fully satisfactory continuing education program and not conducting an external quality control review, our engagement was undertaken in accordance with US Government Auditing Standards issued by the Comptroller General of the United States applicable to agreed-upon procedures.

We believe that the effect of these departures from US Government Auditing Standards are not material because we participate in KPMG South Africa and KPMG International's worldwide internal quality review program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from our affiliate offices. Partners and managers in KPMG South Africa are required to attend technical updates and achieve Continuing Professional Education (CPE) hours, which are in excess of those prescribed by SAICA.

Compliance with agreement terms and laws and regulations applicable to SAEDF is the responsibility of SAEDF's management. As part of our agreed-upon procedures review of the fund accountability statement, we performed tests of *SAEDF's* compliance with certain provisions of agreement terms and laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Findings

We considered the following to be material instances of non-compliance during our agreed upon procedures engagement of SAEDF's fund accountability statement, in accordance with the terms of the agreements and in conformity with the basis of accounting adopted.

Our detailed findings are shown in Appendix 3, to which the reader is referred. There are 30 compliance findings and they may be summarised as follows:

1. Non-compliance with OMB Circular A-122 relating to proper authorised timekeeping records (Page 3);

2. Non-compliance with SAEDF policies and procedures relating to salary increases and bonuses not linked to performance (Page 6);

3. Non-compliance with the Grant Agreement and OMB Circular A-122 relating to CEO benefits. (Page 8);

4. Non-compliance with Section B, point 3.2 of the approved SAEDF HR policy manual relating to performance appraisals and bonuses. (Page 12);

5. Non-compliance with the SAEDF policies and procedures manual for the completion of purchase orders. (Page 14);

6. Non-compliance with the SAEDF policies and procedures manual for the procurement process, namely approval limits and the quotation process. (Page 16);

7. Non-compliance with the Grant Agreement regarding conflict of interest experienced by directors of the grantee. (Page 21);

8. Non-compliance with paragraph 10 (travel expenses) of the SAEDF policies and procedures manual. (Pages 23-33);

9. Non-compliance with paragraph 11 (meals and entertainment) of the SAEDF policies and procedures manual, paragraph 12 (Changes in Corporate Structure and Policies) of the Grant Agreement and Modification No .4 of the Grant Agreement relating to unallowable expenditure. (Page 34);

10. Non-compliance with the Grant Agreement in that all necessary documentation could not be presented by SAEDF management and there was not an adequate audit trail. (Page 36);

11. Non-compliance with the SAEDF HR policy manual with regard to the termination of employees. (Page 41);

12. Non-compliance with the Grant Agreement as the Annual Financial Statements are not issued by January 31 of the following year. (Page 43);

13. Non-compliance with the SAEDF HR policy manual as a performance management process was not in place. (Page 45);

14. Non-compliance with the SAEDF policies and procedures manual regarding the authorisation of expenditure. (Page 47);

15. Non-compliance with SAEDF's accounting manual regarding bank reconciliations. (Pages 50-53);

16. Non-compliance with OMB Circular A-122 requiring costs to be reasonable and kept to the minimum relating to telephone and security costs. (Page 54);

17. Non-compliance with OMB Circular A-122 relating to a prohibition on promotional and advertising costs (Page 57);

18. Non-compliance with the Grant Agreement relating to submitting SF-272 "Federal Cash Transactions Reports". (Page 59);

19. Non-compliance with OMB Circular A-122 relating to reasonable recruitment costs (Page 61);

20. Non-compliance with OMB Circular A-122 relating to training costs (Page 64);

21. Non-compliance with the Grant Agreement regarding program income. (Page 67);

22. Non-compliance with the Grant Agreement relating to approval of investments. (Page 79);

23. Non-compliance with the Grant Agreement relating to investments limits. (Pages 70,85,88,91,95,102,108,114 and 126);

24. Non-compliance with the Grant Agreement relating to inappropriate target groups. (Pages 77 and 117);

25. Non-compliance with the Grant Agreement relating to the maintenance of records. (Page 121);

26. Non-compliance with the Grant Agreement relating to performance of due diligence. (Pages 78, 105 and 111);

27. Non-compliance with the Grant Agreement relating to effective monitoring of investments. (Pages 73, 80, 98, 106 and 123);

28. Non-compliance with the Grant Agreement relating to redemption of shares. (Page 93);

29. Non-compliance with the Grant Agreement relating to the spirit of the Grant Agreement. (Page 119) and

30. Non-compliance with the Grant Agreement relating to an investment outside the target area. (Page 129).

Non-compliance as above results in significant questioned costs being reported under paragraph 2.1, Fund Accountability Statement.

This report is intended for the information of SAEDF 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.

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6 Program Income

6.1 Independent Auditor's report on program income

The Chief Executive Officer
Southern Africa Enterprise Development Fund
Johannesburg

Scope

We have performed the procedures agreed with USAID in the scope of work as contained in Contract number 609-C-00-03-00263, on the accounting records of Southern Africa Enterprise Development Fund (SAEDF) in relation to income, for the period November 1995 to September 30, 1997. Except for not having a fully satisfactory continuing education program and not conducting an external quality control review, our engagement was undertaken in accordance with US Government Auditing Standards issued by the Comptroller General of the United States applicable to agreed-upon procedures.

We believe that the effect of these departures from US Government Auditing Standards are not material because we participate in KPMG South Africa and KPMG International's worldwide internal quality review program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from our affiliate offices. Partners and managers in KPMG South Africa are required to attend technical updates and achieve Continuing Professional Education (CPE) hours, which are in excess of those prescribed by SAICA.

The responsibility for determining the adequacy or otherwise of the procedures agreed to be performed is that of USAID. Our procedures were performed solely to assist you in determining the completeness of program income reported in the Fund Accountability Statement for the above period. The procedures are summarised as follows:

- We selected at least 50% of Fund revenue transactions and tested as follows:
  - Proper control of funds in bank accounts or financial institutions
  - Proper advances of funds in terms of the USAID Grant Agreement and relevant regulations
  - Proper use of program income in terms of USAID regulations

We noted the following:

- Deficiencies in performing bank reconciliations
- General ledger missing for the period from inception to October 1, 1997.

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These matters result in uncertainties as to the completeness of program income, and are reported under compliance in Appendix 3 note 1.18 and 1.25

.

Because the procedures do not constitute an audit made in accordance with U.S. Government Auditing Standards, we do not express any assurance on the completeness of program income for the period October 1, 1995 to September 30, 1997.

Had we performed additional procedures other matters may have come to our attention, which would have been reported to you.

This report is intended for the information of SAEDF and US Agency for International Development (USAID). However, upon release by USAID, this report is a matter of public record and its distribution is not limited. This report relates to the completeness of income and use of program income only, and does not extend to any financial statements of SAEDF taken as a whole.

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7 Status of prior year audit recommendations

7.1 Independent Auditor's Report

The Chief Executive Officer
Southern Africa Enterprise Development Fund
Johannesburg

Scope

We have performed the procedures agreed with USAID in the scope of work as contained in Contract No 609-C-00-03-00263, on the accounting records of Southern Africa Enterprise Development Fund (SAEDF) in relation to matters raised by both the internal and external auditors during the period October 1, 1997 to September 30, 2003. Except for not having a fully satisfactory continuing education program and not conducting an external quality control review, our engagement was undertaken in accordance with US Government Auditing Standards issued by the Comptroller General of the United States applicable to agreed-upon procedures.

We believe that the effect of these departures from US Government Auditing Standards are not material because we participate in KPMG South Africa and KPMG International's worldwide internal quality review program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from our affiliate offices. Partners and managers in KPMG South Africa are required to attend technical updates and achieve Continuing Professional Education (CPE) hours, which are in excess of those prescribed by SAICA.

The responsibility for determining the adequacy or otherwise of the procedures agreed to be performed is that of USAID. Our procedures were performed solely to assist you in determining the status of prior year audit recommendations. The procedures are summarised as follows:

- We obtained a copy of the internal and external audit reports and listed the matters contained therein
- We received such documentation and obtained such explanations, as we considered necessary to determine the status of the audit recommendations.

Findings

Our detailed findings are shown in Appendix 4, to which the reader is referred.

In summary, only 1 out of 9 recommendations by the external auditors for the period 1998 to 2002 has been implemented.

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Appendix 1 Consolidated Fund Accountability Statement

Appendix 1

THE SOUTHERN AFRICAN ENTERPRISE DEVELOPMENT FUND (SAEDF)
CONSOLIDATED FUND ACCOUNTABILITY STATEMENT
PERIOD OCTOBER 1, 1997 TO SEPTEMBER 30, 2003

	BUDGET	ACTUAL	QUESTIONED COSTS TOTAL	INELIGIBLE	UNSUPPORTED	NOTES
	US$	US$	US$	US$	US$	
REVENUE						
Grant proceeds for Investments	36 867 000	54 121 436		0	0	
Grant proceeds for Operations	11 228 731	5 630 538		0	0	
Total drawdowns from USAID	48 095 731	59 751 974		**0**	**0**	
Investment income	4 397 901	3 639 023		0	0	
Investments sold	1 487 419	1 907 629		0	0	
Capital repayments	0	10 000 016		0	0	
Interest income	2 222 738	1 781 302		0	0	
Fee, rental, miscellaneous income	2 149 976	1 989 654		0	0	
Bad debts recovered	0	308 704		0	0	
Proceeds from long term loan	0	824 896		0	0	
Proceeds on disposal of property, plant and equipment	0	2 387		0	0	
Total Operational revenue	10 258 034	20 453 611				
Total Revenue	**58 353 765**	**80 205 585**				
COSTS						
Operating activities						
Professional services	3 572 271	3 450 496	691 822	206 555	485 267	**Note 1**
Employee compensation and benefits	10 094 025	9 198 572	7 168 681	472 068	6 696 613	**Note 2**
Business expenses	3 048 607	2 416 469	1 059 326	111 541	947 785	**Note 3**
Administrative and other	2 261 914	3 071 543	343 794	84 151	259 643	**Note 4**
Restructuring Costs	0	379 703	151 612	147 554	4 058	**Note 5**
Total operational costs incurred	18 976 817	18 516 783				
Investing activities						
Investments made	0	44 224 006	22 631 246	22 631 246	0	**Note 6**
Capital expenditure	349 031	343 789		0	0	
Total Investing costs	349 031	44 567 795				
Financing activities						
Repayment of long term loan		767 776		0	0	
Total costs incurred	**19 325 848**	**63 852 354**				
(Decrease) / Increase in cash equivalents	**39 027 917**	**16 353 231**				
Bank balance at beginning of the year	0	3 418 776				
less foreign exchange loss	29 000	980 559				
Bank balance at end of the year	**38 998 917**	**18 791 448**				

Appendix 1

Notes to the Consolidated Fund Accountability Statement

Expenditure

Note 1 - Professional Services

Professional services is made up of the following accounts,

- Accounting Fees
- Legal Fees
- Consulting Fees
- Program Development
- Staff Training
- Temporary Help.

The questioned costs for this category can be analysed as follows,

Questioned Costs				
Total	**Ineligible**	**Unsupported**	**Reason**	**Reference to Findings Report**
$485,267		$485,267	Inadequate documentation and audit trail	Appendix 3 Note 1.13
$152,857	$152,857		Procurement Process	Appendix 3 Note 1.6
$53,698	$53,698		Training costs	Appendix 3 Note 1.24
$691,822	**$206,555**	**$485,267**		

EXPLANATION OF QUESTIONED COSTS

Inadequate documentation and audit trail

An adequate audit trail did not exist between the general ledger and the supporting documentation for some of the transactions. For such transactions it was not possible to trace the general ledger transactions to the documentation to assess the validity of the expenses incurred. For a number of credit card transactions reviewed it was noted that the invoice from the service provider was not available, the only supporting documentation was the credit card slip. It was therefore not possible to ascertain the components of the expense and its validity.

Additional supporting documentation for the question costs originally reported was provided by SAEDF. The additional documentation reduced the question costs by 38% but certain documentation provided by SAEDF was still inadequate. Examples include: authorised memorandum provided but no invoice or travel authorisation form was provided, no documentation supporting authorised journal entries, original invoices were not provided – only faxed or copy invoices and/or no supporting documentation was provided for expenses incurred on company credit cards.

Procurement Process

Consulting work performed by Mckinsey for $112,857. There was no evidence of a tendering process being followed, quotations being obtained, approval according to the set limits i.e. no evidence of formal Chairman or Board approval. A contract was awarded to a consultant for a SAR Review. This contract was worth $40,000. No tendering process was followed for the awarding of the contract and no other quotes were obtained.

Excessive training costs

Training costs appeared excessive in relation to the training received. Training received by employees was not monitored by means of an individual development plan. No evidence exists that staff were sent on training courses based on developing the skills that were identified in the individual development plan. Employees received training during the period in which restructuring was being performed by SAEDF and the future of employees at SAEDF was not certain. Therefore, the benefit to SAEDF of the training provided to staff members is questionable as high staff turnover was experienced.

Note 2 -Employee Compensation and Benefits

Employee Compensation and Benefits are made up of the following accounts,

- Salaries
- Company Contributions – Employee Benefits
- Employee Taxes
- Bonuses
- Other Allowances
- Staff Recruitment.

For the 2002 and the 2003 financial years staff training is included in this category whereas for the financial years 1998 to 2001 staff training is included in professional services.

The questioned costs for this category can be analysed as follows,

Questioned Costs				
Total	**Ineligible**	**Unsupported**	**Reason**	**Reference to Findings Report**
$6,236,872		$6,236,872	Timekeeping	Appendix 3 Note 1.1
$389,898		$389,898	Bonus payments	Appendix 3 Note 1.4
$275,130	$275,130		Housing and car allowances	Appendix 3 Note 1.3
$84,143	$84,143		Appointment of recruiting agencies	Appendix 3 Note 1.23
$60,529		$60,529	Inadequate documentation and audit trail	Appendix 3 Note 1.13
$89,293	$89,293		CEO Benefits	Appendix 3 Note 1.3
$23,502	$23,502		Training costs	Appendix 3 Note 1.24
$9,314		$9,314	Life assurance payments	Appendix 3 Note1.1
$7,168,681	**$472,068**	**$6,696,613**		

EXPLANATION OF QUESTIONED COSTS

Timekeeping

Timekeeping is raised as a questioned cost as the requirements of Circular A-122 are not complied with, namely there are no activity reports to support the payroll and an employee attendance register and employee timesheets were not kept. The payroll was also not authorised. No indication exists that leave forms were submitted by employees and therefore no record was kept of employees exceeding the allowed days leave. This could also have resulted in a leave payment being made on the resignation of an employee, which would be an overstatement. This amount comprises of the following, Salary costs - $5,418,102, Employee compensation benefits – Medical aid and Provident fund - $769,957, Leave Pay - $48,813).

Bonus Payments

Bonus payments were not approved by the Board of Directors for 2002 and no correlation existed between a bonus paid to an employee and the employee performance review.

Housing and car allowances

A housing and car allowance was granted to the CEO. The policies and procedures state that such a housing allowance must be set at a reasonable level on the basis of market circumstances. On review of the housing allowance it was discovered that this requirement was not met. Circular A-122 states that the cost of automobiles that relate to personal use by employees (including transportation to and from work) is unallowable as a fringe benefit regardless of whether the cost is reported as taxable income by the employee.

Staff recruitment

A well-managed recruitment program was not in place and rates charged by recruiting agencies varied substantially from year to year. During the 2002 year Equal Access Consulting (EAC) was used exclusively for SAEDF recruiting requirements. It was discovered that this recruiting agency was recommended by one of the members of the Board of Directors, who was also a director of EAC's holding company – Adcorp. The rate charged by EAC appeared excessive considering that SAEDF gave them all its business.

Inadequate documentation and audit trail

An adequate audit trail did not exist between the general ledger and the supporting documentation. For such transactions it was not possible to trace general ledger transactions to documentation to assess the validity of the expenses incurred. Upon inspection of the employee files employee contracts could not be located for certain employees and the validity and accuracy of these employee salaries and benefits could not be confirmed.

Additional supporting documentation for the question costs originally reported was provided by SAEDF during January 2005. The additional documentation reduced the question costs by 28%.

CEO Benefits

These costs relate to the tuition paid for the CEO – Rob Kelley's children. As no contract existed between the CEO and SAEDF difficulty arose in determining a reasonable benefit. On review of these costs they appear to be excessive.

Excessive training costs

Training costs incurred appeared excessive in relation to the training received. Training received by employees was not monitored by means of an individual development plan. No evidence exists that staff were sent on training courses based on developing the skills that were identified in the individual development plan. Employees received training during the period in which restructuring was being performed by SAEDF and the future of employees at SAEDF was not certain. Therefore, the benefit to SAEDF of the training provided to staff members is questionable as high staff turnover was experienced.

Life assurance payments

SAEDF made life assurance payments on behalf of non-SA employees. These payments were not approved by the Board of Directors.

Note 3 – Business Expenses

Business Expenses is made up of the following accounts,

- Overseas and local travel
- Board meeting expenses
- Entertainment
- Motor vehicle hire and mileage claims

Questioned Costs				
Total	**Ineligible**	**Unsupported**	**Reason**	**Reference to Findings Report**
$296,931	$9,468	$287,463	Officers and employees travel expenses	Appendix 3 Note 1.10
$325,338		$325,338	Authorisation for travel and accommodation and credit card expense authorisation	Appendix 3 Note 1.8
$124,945		$124,945	Inadequate documentation and audit trail	Appendix 3 Note 1.13
$8,747	$6,574	$2,173	Unreasonable costs	Appendix 3 Note 1.20
$283,432	$75,566	$207,866	Board members expenses	Appendix 3 Note 1.9
$19,933	$19,933		Unreasonable / excessive ineligible costs	Appendix 3 Note 1.11
$1,059,326	**$111,541**	**$947,785**		

EXPLANATION OF QUESTIONED COSTS

Officers and employees travel expenses

Actual travel expenses incurred by employees of the fund were not supported by adequate documentation and the validity of the travel expense could not be ascertained due to this lack of documentation. If actual expenses were not paid for by SAEDF, employees received a per diem rate per day. The policies and procedures regarding the payment of per diem rates were not complied with and in certain instances the approved US per diem rate for the specific location was exceeded. Actual travel expenses paid by SAEDF were compared to the per diem rates to verify the reasonableness of the expense and in the majority of cases the actual expense exceeded the approved per diem rate for the location.

Authorisation for travel and accommodation and credit card expense authorisation

Travel forms were not completed for all travel that was undertaken by employees and this resulted in travel being undertaken that was not authorised. SAEDF have provided us with travel forms which could previously not be located and question cost were adjusted accordingly. However, a large number of travel forms are still outstanding.

The policies and procedures state that the credit card statement must be authorised by senior officials but such authorisation did not take place and items remain as question costs.

Inadequate documentation and audit trail

An adequate audit trail did not exist between the general ledger and the supporting documentation for some of the transactions. For such transactions it was not possible to trace the general ledger transactions to the documentation to assess the validity of the expenses incurred. For a number of credit card transactions reviewed it was noted that the invoice from the service provider was not available, the only supporting documentation was the credit card slip. It was therefore not possible to ascertain the components of the expense and its validity.

Additional supporting documentation for the question costs originally reported was provided by SAEDF. The additional documentation reduced the question costs by 10%. The majority of documentation provided by SAEDF was inadequate. Examples include: authorised memorandum provided but no invoice or travel authorisation form was provided, no documentation supporting authorised journal entries, original invoices were not provided – only faxed or copy invoices were provided or no supporting documentation was provided for expenses incurred on company credit cards.

Excessive telephone costs

Excessive telephone costs were incurred by employees who were travelling and for certain of these telephone costs there was no supporting documentation available to ascertain whether the costs incurred were of a business or a personal nature.

Board members expenses

Expenses incurred by members of the board were not always supported by adequate documentation as is required by the policies and procedures. Costs incurred by board members were compared to US approved per diem rates as a reasonableness measure and it was discovered that certain costs exceeded the per diem rates by a large percentage.

Unreasonable / excessive ineligible costs

The executive assistant / office manager took various trips that did not appear to be required. In certain instances there were unreasonable or prohibited expenses, e.g. purchase of alcohol, business class travel, entertainment costs not complying with Circular A-122. For one of the Board meetings held at the Westcliff hotel, Johannesburg, the bill for accommodation included 33 "No Show" charges for bookings not taken up, which is considered wasteful.

Note 4 – Admin and other

Admin and other is made up of the following accounts,

- Advertising
- Promotions
- Rent and rates
- Electricity and water
- Telephones
- E-mail expenses
- Computer Maintenance
- Repairs and maintenance
- Motor Vehicle Costs
- Insurance
- Interest Paid
- General Expenses
- Other Expenses

Questioned Costs				
Total	**Ineligible**	**Unsupported**	**Reason**	**Reference to Findings Report**
$259,643		$259,643	Inadequate documentation and audit trail	Appendix 3 Note 1.13
$1,753	$1,753		Unallowable expenditure	Appendix 3 Note 1.12
$66,017	$66,017		Procurement Process	Appendix 3 Note 1.6
$2,500	$2,500		Advertising and promotions	Appendix 3 Note 1.21
$11,812	$11,812		Unreasonable costs	Appendix 3 Note 1.20
$2,069	$2,069		Unreasonable costs	Appendix 3 Note 1.20
$343,794	**$84,151**	**$259,643**		

EXPLANATION OF QUESTIONED COSTS

Inadequate documentation and audit trail

An adequate audit trail did not exist between the general ledger and the supporting documentation. For such transactions it was not possible to trace general ledger transactions to documentation to assess the validity of the expenses incurred. In cases were an audit trail existed, when this audit trail was followed, no supporting documentation was available to assess the validity of the expense which was being reviewed.

For a number of credit card transactions reviewed it was noted that the invoice from the service provider was not available, the only supporting documentation was the credit card slip. It was therefore, not possible to ascertain the components of the expense and its validity. For certain credit card transactions no indication existed of what the transactions posted to the general ledger consisted of.

Additional supporting documentation for the question costs originally reported was provided by SAEDF. The additional documentation had reduced the question costs by 5%. Majority of the documentation provided by SAEDF was inadequate. Examples include: authorised memorandum provided but no invoice or travel authorisation form was provided, no documentation supporting authorised journal entries, original invoices were not provided – only faxed or copy invoices or no supporting documentation was provided for expenses incurred on company credit cards.

Unallowable Expenditure

This amount consists of alcohol purchased of $1,753; OMB Circular A-122 specifically prohibits these costs.

Procurement Process

These costs relate to Ambassador Andrew Young Awards Dinner ($56,329) and hosting a display stand at the World Summit on Sustainable Development ($9,688). No evidence exists that a formal supplier selection process was followed, i.e. quotation obtained or tender process followed.

Advertising and Promotions

These costs relate to advertising and promotional costs incurred, namely Ambassador Andrew Young's birthday party. This cost is unallowable per OMB Circular A-122.

Excessive telephone costs

Excessive telephone costs were incurred by employees who were travelling on SAEDF business.

Security at employees' personal residences

SAEDF paid for security systems, armed response, electric fences and security gates at the residences of South African employees, which is not allowed by OMB Circular A-122.

Note 5 – Restructuring Costs

Restructuring costs are made up of the following accounts,

- Personnel Settlement
- Legal Costs
- Consulting Fees
- Board of Directors

Questioned Costs				
Total	**Ineligible**	**Unsupported**	**Reason**	**Reference to Findings Report**
$147,554	$147,554		Lump sum paid on retrenchment	Appendix 3 Note 1.14
$4,058		$4,058	Authorisation for travel and accommodation	Appendix 3 Note 1.14
$151,612	**$147,554**	**$4,058**		

EXPLANATION OF QUESTIONED COSTS

Lump sum paid on retrenchment

Retrenchment payments were made to 4 employees. On review of the 2003 Board Meeting minutes no evidence could be located to authorise these payments. It was discovered that subsequently additional people were employed and this questions the reason these employees were retrenched.

Authorisation for travel and accommodation

This relates to the cost incurred for an employee having to travel back from training in the USA in order to testify at an arbitration hearing. No travel authorisation form could be located for the travel undertaken.

Note 6 - Investments

	Questioned Costs				
Name of Investment	**Total**	**Ineligible**	**Unsupported**	**Main reasons**	**Reference**
African Bank Corporation Holdings	$4,000,000	$4,000,000	0	Exceeded maximum investment limits.	Appendix 3 Note 1.26
Ahanang Construction CC	$34,120	$34,120	0	Poor maintenance of records and monitoring.	Appendix 3 Note 1.27
Babete/ Maxiprest	$170,240	$170,240	0	Not within the investment target group, non compliance of the Grant Agreement, Not approved by Board, exceeded authorised limits	Appendix 3 Note 1.28
Eerste River Medical Centre (Cape Limited)	$900,000	$900,000	0	Lack of monitoring	Appendix 3 Note 1.29
Gili Greenworld	$916,783	$916,783	0	Exceeded maximum investment limits	Appendix 3 Note 1.30
Kagiso Ventures Private Equity Fund	$2,184,127	$2,184,127	0	Exceeded maximum investment limits.	Appendix 3 Note 1.31
Kingdom Securities Holdings Limited	$646,308	$646,308	0	Exceeded maximum investment limits. Redemption of shares	Appendix 3 Note 1.32.
Megkon (Pty) Ltd/Autoster	$2,767,036	$2,767,036	0	Exceeded maximum investment limits.	Appendix 3 Note 1.33
Mozambique Equity Fund	$882,000	$882,000	0	Monitoring of investments	Appendix 3 Note 1.34
Metals Closure Group	$1,159,036	$1,159,036	0	Exceeded maximum	Appendix 3 Note 1.35

	Questioned Costs				
Name of Investment	Total	Ineligible	Unsupported	Main reasons	Reference
South Africa Limited				limits	
Pick-a-Spaza Holdings	$1,054,731	$1,054,731	0	Inadequate due diligence performed, poor monitoring, exceeded investment limits	Appendix 3 Note 1.36
TV Africa/Africa Broadcasting Network	$6,718,238	$6,718,238	0	Inadequate due diligence performed, exceeded maximum investment limits, contravention of the Grant agreement,	Appendix 3 Note 1.37
Ubambo Telecomm. (Pty) Ltd	$59,070	$59,070	0	Contravention of the Grant Agreement	Appendix 3 Note 1.38
Vantaris Capital Fund	$78,263	$78,263	0	Poor Maintenance of records.	Appendix 3 Note 1.39
Zambia Pork Products	$1,050,000	$1,050,000	0	Lack of monitoring and exceeded investment limits	Appendix 3 Note 1.40
Ruashi Copper-Cobalt Mine	$11,294	$11,294	0	Site visit to the Democratic Republic of Congo,	Appendix 3 Note 1.41
Totals	**$22,631,246**	**$22,631,246**	**0**		

EXPLANATION OF QUESTIONED COSTS

The questioned costs are mainly attributable to investments exceeding the credit limits as set in the Investment Policies and Procedures or ineffective monitoring of investments resulting from long delays from approval of investment to date of monitoring.

In addition, certain investments have been questioned as a result of the lack of or poor due diligences being performed prior to disbursements. In certain instances the due diligence procedures were performed after the investment was made. Due diligences performed were not adequate and did not address all the key issues. In certain instances information obtained from the due diligence procedures was not acted upon.

Appendix 2 Summary of findings – Internal control issues

Appendix 2

Summary of findings

Internal control issues

February 2005

This report contains 47 pages

Appendix 2

Contents

1.0 Notes on COSO Control framework

The Committee of Sponsoring Organisations of the Treadway Commission (COSO) launched a framework that defines risk and enterprise risk management, and provides a foundational definition, conceptualisations, objective categories, components, principles and other elements of a comprehensive risk management framework. It provides direction for companies and other organisations in determining how to enhance their risk management architectures, providing context for and facilitating application in the real world. This document is also designed to provide criteria for companies' use in determining whether their enterprise risk management is effective and, if not, what is needed to make it so.

The COSO framework deals with a portfolio of indirect and direct controls that companies should implement to manage their risks.

Recognising the need for definitive guidance on enterprise risk management, COSO initiated a project to develop a conceptually sound framework providing integrated principles, common terminology and practical implementation guidance supporting entities' programs to develop or benchmark their enterprise risk management process. A related objective is for this resulting framework to serve as a common basis of managements, directors, regulators, academics and others to better understand enterprise risk management, its benefits and limitations, and to effectively communicate about enterprise risk management issues.

As a United States Government Program, SAEDF should use technically developed standards or norms with regard to its internal controls. Footnote #75 (paragraph 6.34.a) to the US Government Auditing Standards (2003 Revision) indicates that the COSO Framework is a source "of established criteria auditors can use to support their judgements and conclusions about internal control."

1 Detailed Findings - Internal control issues - Reportable conditions

1.1 Bonus payments

Criteria

According to OMB Circular A-122, Attachment B, paragraph 7, changes to awards for salaries and wages including bonuses will be based on documented payrolls approved by a responsible official of the organisation.

Condition:

- SAEDF's HR policies do not indicate that bonuses need to be approved by senior officials of the organisation.
- It also appears that bonuses for the period 2002 were paid without consultation of the Board.

Cause:

- Poor design of HR policies
- Bonuses paid at the sole discretion of the CEO.

Effect

- Invalid bonus may have been made or excessive bonus amounts may have been made.

Recommendation

- The HR policies of SAEDF need to be redrafted to include details regarding processes to be followed for paying bonuses i.e. consultation with Board and documentation approval by senior officials.

Management comment

Historically SAEDF bonuses are approved by the Chief Executive Officer, in consultation with the other departmental heads. The Chief Financial Officer approves and reviews all salary-related expenditures, reconciliations and journal entries. As the Chief Executive Officer, Chief Financial Officer and Vice Presidents are signatories to the Southern Africa Enterprise Development Fund ("SAEDF") bank accounts no payment can be made without their viewing the payment documentation. SAEDF is currently reviewing its Human Resources ("HR") policies and will include senior management review and approval in the HR Manual.

The auditor's statement is incorrect. All SAEDF bonuses are presented, discussed and approved by the SAEDF board Human Resources Committee. In addition, the SAEDF board reviews the SAEDF financials on a quarterly basis and any variances above budget are questioned and explained by the Chief Financial Officer and Chief Executive Officer.

Management disagrees that the HR policies were poorly designed. It would be more correct to state that the HR policies were adequate, yet they were not always adhered to.

Management agrees with the effect and recommendations.

KPMG Comment

Additional minutes of board Human Resources Committee were provided and finding has been adjusted where sufficient audit evidence was provided indicating that board approval was obtained for payment of bonuses. No evidence was provided for 2002 bonus payments.

Management have however agreed with our recommendations and should they implement this, the weakness with regard to Bonus payments will be resolved.

1.2 Authority of CEO

Criteria

The process oversight section of the COSO control model requires board oversight as well as the establishment of authority grids and structures to ensure good corporate governance.

Condition

The various CEO's of SAEDF have had a significant amount of authority i.e.

- For the years 1999-2002 bonuses were awarded at the sole discretion of the CEO
- CEO's awarded excessive increases to certain staff
- CEO's made decisions regarding terminations
- The operating style of CEO's was dominating and intimidating
- CEO's did not always adhere to SAEDF policies and procedures e.g. R Kelley entered into investments without the necessary approval and, incurred expenses over his approval limit

Cause

- No signed CEO employment contracts in place clearly indicating responsibilities and authority of CEO.
- No evidence of CEO's performance being formally evaluated by the Board.

Effect

- Excessive or inappropriate bonuses given to employees.
- Favouritism of staff impacting on employee morale.
- Unnecessary costs incurred by SAEDF due to terminations

Recommendation

- SAEDF should improve board oversight by preparing:
  - An employment contract that should be signed with the CEO, clearly indicating his roles and responsibilities;
  - Ensuring that a sub-committee of the board formally evaluates the CEO's performance annually; and
  - Establishing authority grids, which clearly indicate accountability and transparency.

Management Comment

SAEDF bonuses are approved by the Chief Executive Officer in consultation with the other departmental heads. However, it is correct that the Chief Executive Officer had the final say on bonus (and salary increase) figures and percentages.

Management agrees that certain staff received excessive bonuses.

As with bonuses and salary increases it is agreed that the Chief Executive Officer did have the final authority (at executive/management level) with regard to terminations.

Management does not feel it can comment on the CEO's dominating and intimidating management style.

It is agreed that the Chief Executive Officer acted incorrectly in the two instances mentioned. It was these, and other, issues that eventually led to his termination.

Contracts were signed with the US legal counsel-approved contract.

The Chief Executive Officer performance was discussed during the Executive Sessions of the SAEDF board meetings. The Chief Executive Officer was usually requested to leave the room while his performance was reviewed. For example in the board minutes of November 1999 the Chief Executive Officer was warned that his performance was directly linked to the Fund's performance.

Management agrees with the recommendations.

KPMG Comment

No additional evidence provided to us indicating that signed contracts were in place with CEO for period under review. As no additional evidence provided to us, our original findings remain. Management agree with our recommendations and if these recommendations are implemented, the controls with regard to the process oversight will improve.

1.3 Monitoring of budget

Criteria

- The COSO Control model under the section on indicator and measurement requires that organisations insert tools in place to monitor how well or not they are achieving their objectives. A budgeting process would fall into this category. The budgeting process would need to ensure that all categories of expenses have been provided for.
- In KPMG's opinion Actual expenses should be monitored against budgeted expenditure and all variances should be investigated. Where budgets are expected to be exceeded, prior written approval should be obtained from the CEO or Board of Directors.

Condition

- SAEDF has adopted a zero based budgeting process. This budgeting process was a bottom-up process whereby managers justified their financial requirements. The overall budgets were approved by the Finance and accounting committee and then the Board. There was however no evidence that the variances were effectively followed up or that prior approval was obtained in instances where the budgets were expected to be exceeded.
- From the review of the actual verses budgeted expenditure for 1998 to 2003 of the various categories of expense accounts, the following actual expenditure exceeded the budgeted amounts and no formal written approval was obtained:

Number	*Year*	*Account category*	*Budget exceeded by*
1	1998	Administration and other expenses (Telecommunications is included in this account)	$62,523
2	1999	Administration and other expenses (Telecommunications and interest paid are included in this account)	$83,674
3	2000	Administration and other expenditure	$279,480
4	2001	Professional fees (This excess is mainly due to legal fees)	$135,879
5	2001	Administration and other expenses	$262,364
6	2001	Business expenses	$22,794
7	2002	Professional fees	$187,444
8	2002	Business expenses	$6,607

Number	Year	Account category	Budget exceeded by
9	2002	Administration and other expenses	$43,721
10	2003	Professional fees	$145,749
11	2003	Administration and other expenses	$51,023
12	2003	Restructuring costs	*$379,703

* These expenses were not budgeted for at all.

Cause

Lack of adequate policy and procedures in place regarding the monitoring of budgets and controlling of expenditure in instances where budgets were expected to be exceeded.

Effect

- Over-expenditure and SAEDF's money may not be utilised in the best possible manner.
- Expenditure incurred was not in line with budgets and the Board of Directors did not approve the excess expenses. This excess expenditure may therefore not be valid as no approval was available.
- Unreasonable / excessive costs may be borne by SAEDF.

Recommendations

- The policy regarding the budgeting process needs to be enhanced and should include:
    - Budgets to be monitored by the finance and accounting committee on a quarterly basis. They should investigate all material variances
    - Management to obtain prior, written approval from the Board/CEO in all instances where budgets are expected to be exceeded.

Management Comment

SAEDF budgets are approved by the board. SAEDF submits quarterly Treasurer's Reports to the Audit Committee of the board, which includes detailed financials as well as detailed narrative on any expenditure above budget. Management are questioned about the reports during the SAEDF board meetings. SAEDF Finance and accounting also adopted a "real-time" approval process whereby expenditure could be checked against budget before approval was granted. The system involved the Financial Manager monitoring all expenditure via the purchase requisitions. Any expenditure resulting in the budget being exceeded would have to be approved by the Chief Financial Officer, Chief Executive Officer or Senior Vice President. These expenses would usually have been unavoidable, yet necessary, expenses.

It is unclear what income statement accounts the auditors used for the calculation of the differences as SAEDF's figures differ as follows:-

- 1998: General and Admin was $51,608 above budget, mainly due to telecommunication expenses being $33,038 above budget.
- 1999: General and Admin was $59,330 above budget, mainly due to an $88,837 provision for bad debts. No budget amount was provided for bad debts.
- 2000: General and Admin was $309,605 above budget, mainly due to a $300,727 provision for bad debts. No budget amount was provided for bad debts .
- 2001: General and Admin was $271,953 above budget, mainly due to a $385,967 provision for bad debts, where no budget amount was provided (therefore expenditure was actually below budget). Board expenses were $69,417 above budget, which caused business expenses to be above budget. Board expenses were extremely difficult to budget for as the location and attendees were unknown at the time of preparing the budget.
- 2002: The format of the income statement was changed by the Chief Financial Officer making comparisons to prior years difficult (certain expense accounts were included under different category heads to prior years). SAEDF also had an independent party value its investment in Loita at a cost of $37,600 (also not budgeted for). As in 2001 business expenses were above budget as a result of board expenses ($99,125 above budget).
- 2003: Expenditure was above budget as a result of the Chief Executive Officer termination expenses ("restructuring costs").

Note: The statement that restructuring costs were not budgeted for "at all" is self-explanatory. Budgeting for the expenses would have meant that SAEDF intended to terminate the Chief Executive Officer's services prior to knowing of any offences. The expenses were incurred as a direct result of legal action taken by the former Chief Executive Officer against SAEDF and were therefore impossible to forecast.

Management only agrees with the comment with respect to board expenses. For all other expenses management had control over and monitored variances via the monthly and quarterly financial reports issued to management and the SAEDF board.

Recommendation 1 is already in place, and has been for some time. Previously the Chief Financial Officer approved any possible excess expenditure and as most expenses in question were approved by the Chief Executive Officer or relate to board expenses (also approved by Chief Executive Officer) management does not see how the process will differ from the one currently in place.

KPMG Comment

The figures from the trial balance provided to us, were used for the calculation of differences between actual and budget. We used the allocations of accounts as provided to us by the accounting staff from SAEDF. There may have been differences in what accounts we used in the make of categories (i.e Admin& other) vs. what the previous financial manager used.

We do agree that actuals vs. budget were presented to the Audit Committee with explanations, we however could not find any evidence that any action was taken were budgets were exceeded and we also could not find any evidence of a "real time" approval process were expenditure are checked against budget before approval. Our original finding remains.

1.4 Excessive number of journals entries

Criteria

Section 24.1 of SAEDF's policies and procedures states that SAEDF's financial management system shall provide for accurate, current and complete disclosure for each of SAEDF's sponsored activities.

Condition

- A large number of journal entries were processed. Many journals entries were processed more than once due to:
  - Incorrect allocations in the original journal entries.
  - Incorrect details being processed on the original journal entries.
  - Numerous journal entries do not facilitate accurate reporting.

Cause

- Lack of sound accounting practice, initial errors or even a possible attempt to disguise transactions.
- Lack of knowledge by staff.

Effect

- The increase in the number of journal entries being processed increases the likelihood of errors and this increases the risk of financial information not being accurate.
- Transactions may also be disguised.
- The excessive number of journal entries also impacts on the time taken to prepare final accounts, as there is not always an adequate audit trail.

Recommendations

- SAEDF management must draw up a formal policy for journal entries.
- This policy must require comprehensive explanations and supporting documentation for journal entries, and authorisation by the CFO and as far as is possible journal entries should be kept to a minimum.
- Suitably qualified staff should be recruited and staff should receive the necessary training.

Management Comment:

Management disagrees with the comment. In 1998 the journals were a direct result of the process undertaken by the newly established full-time Finance and accounting department - of installing Accpac correctly. Prior to this the SAEDF accounting functions were outsourced to Deloitte and Touche. The Accpac system installed at the time only print out a detailed trial balance. SAEDF undertook to reconstruct the entire system. A new chart of accounts, new reporting formats and new cost centres were created. As the previous system was useless as a reporting tool management created a parallel database with the new system. The trial balances were reconciled and for a few months the systems were run in parallel (all entries were captured into both databases). Any journal entries had to be captured into both databases according to the respective database account codes. The journals were a result of "splitting" the entries in the old system into more specific categories in the new system. For example the old system had an expense item called "travel", while the new system too had travel, but it was further split into accommodation, airfares etc. SAEDF therefore had to allocate every travel related item into the new categories – via journals. In later years the journals were partly due to misallocations, or errors in capturing. However, as the Financial Manager approved all batches prior to posting, the entries were usually a result of management (Chief Financial Officer) disagreeing with the allocation and requesting the Financial Manager to reallocate the entry. As an additional control SAEDF utilized control accounts in the balance sheet. Any payroll, staff debtor, trade creditor, unknown expenses etc were allocated to these accounts and only expensed to the income statement (via journals) when the relevant reconciliation had been performed or the unknown expenditure clarified.

The journals were performed to provide more accurate information and therefore more meaningful financial statements, and therefore the end justifies the means (see above).

Management disagrees that any of the staff involved lacked knowledge.

Management feels that the drawing up of a formal journal policy is unnecessary. In future the Chief Financial Officer will review all journals generated by the accountant and Financial Manager.

Supporting documentation is attached to journals in all instances, or the reference number of the original payment is given on the face of the journal. The majority of the disputed journals were reallocations or allocations of prepaid expenditure. In both cases it is completely unnecessary to attach anything but the general ledger printout or the reconciliation.

Suitably qualified staff was employed by SAEDF and the individuals' qualifications can be found in their personnel files.

KPMG Comment

No additional evidence provided to indicate change in finding. Original finding remains.

1.5 Monitoring of Telephone costs

Criteria

- According to Circular A-122: 'A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. In determining the reasonableness of a given cost, consideration shall be given to:
  - Whether the cost is of a type generally recognized as ordinary and necessary or the operation of the organization or the performance of the award.
  - Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.
  - Significant deviations from the established practices of the organization, which may unjustifiably increase the award costs.'

Condition

During the review of the expenditure accounts the following was noted:

There is no evidence of effective monitoring over telephone costs.

Telkom Costs

- SAEDF have not requested Telkom to supply invoices that provide amounts billed per extension. Therefore it was not possible to analyse the account and determine if there was possible excessive use of the telephone by certain extensions. In addition, SAEDF has its own system that analyses the telephone costs per extension but there is no evidence of this system being used.

Telephone costs claimed by employees

- There is no formal process in place regarding the payment of telephone costs incurred while individuals are on business trips

Cause

Poor management practices and no apparent attempt to keep costs reasonable and to a minimum level.

Effect

- Due to lack of control over telephone expenditure, there may be unnecessary and excessive use of USAID funds.

- SAEDF may pay for private costs that are not business related, as there is no evidence of monitoring of telephone calls.

Recommendations

- Telkom should be requested to supply invoices that provide account details per extension. Telephone costs per extension number should be monitored to determine if there is abuse of telephone expense.
- Telephone claims from employees should be analysed to determine whether they are valid business calls by requesting an itemised billing before these costs are reimbursed and individuals should justify costs that are business related.

Management Comment

SAEDF is monitoring telephone usage. In 1999/2000 SAEDF Finance and accounting department identified that telephone costs were excessive, even though SAEDF at the time had over 30 employees. SAEDF purchased a telephone monitoring system that could monitor telephone calls per extension. Each employee was given a separate extension as well as a phone locking number, to prevent other employees from using their extension. The total costs for all extensions equalled the Telkom account for the particular month. Each month Finance and Accounting reviewed the printouts, per extension, and highlighted the following:

- Calls of excessive duration,
- Calls to foreign countries not in the SADC region,
- Calls to SADC countries not relevant to the particular department or investment group, and
- Any other frequently recurring numbers (especially cell numbers).

The costs per extension were captured into an excel schedule to show trends in phone abuse. Employee's whose monthly charges were excessive were highlighted to their relevant manager, who in turn spoke to the employee. If the employee continued to make excessive calls the charges were deducted from their salaries (see L. Isaacs and L. Khoza). Immediately after instituting the above process total phone charges reduced.

SAEDF has a long established formal expense claim policy. Staff are permitted 2 personal calls, paid by SAEDF, while travelling. All other calls are either personal or business. Personal calls are identified as such by the traveller and deducted from the M&IE travel advance given to the employee. The head of department then approves the expense claim as proof of acceptance of the expenditure. Any questionable costs are discussed with the employee and if no satisfactory explanation is given are deducted from the travel advance too. Business calls are paid by SAEDF. As with annual leave this system also relies on staff honesty and integrity in identifying personal/business expenses. SAEDF is satisfied with the controls.

Management disagrees (see above) that poor management practices existed and there was no attempt to reduce costs.

There is no need to request this service from Telkom as the phone monitoring system can do this. All SAEDF telephone costs are evidenced by itemized bills.

Almost every hotel SAEDF travel to provides itemized billings per room number. All employees are required to identify all (not only telephone calls) business and personal expenditure on their hotel bills. SAEDF will also review its cell phone reimbursement policy to only reimburse SAEDF staff for actual business calls.

KPMG Comment

We do acknowledge that SAEDF has a telephone monitoring system but there was no evidence to indicate that this system was used to monitor calls. We could also not obtain evidence that a formal policy regarding staff telephone call while on business trips existed and that relatively expensive calls on hotel bills were flagged and followed up. Our original finding remains. Our original finding remains.

1.6 Timekeeping

Criteria:

According to OMB Circular A 122, Attachment B, paragraph 7(m):

a. Charges to awards for salaries and wages will be based on documented payrolls approved by responsible officials of the organisation.

b. The distribution of salaries and wages must be supported by personnel activity reports. These reports must reflect the distribution of activity of each employee. Each report must account for the total activity for which employees are compensated and which is required in fulfilment of their obligations to the organisation. The reports must be prepared at least monthly and must coincide with one or more pay periods. Also, the reports must be signed by an individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee.

According to the approved HR policies and procedures manual, paragraph 12 of the policies and procedures section:

1. SAEDF shall maintain adequate records, which reflect the payment of salaries and reasonable compensation to directors, officers and employees; and

2. Any increases in salaries or other compensation shall be approved by the Board of Directors. The Board may choose to delegate to the chief executive officer the reasonability and authority for setting of salaries for employees other than the chief executive officer.

Condition:

For the years 1998 – 2003:

- There is no evidence that salary schedules have been signed and reviewed by an independent person prior to submission to the outside consultant for processing.
- There are no attendance registers, activity reports or timesheets kept by employees to record the time spent at work as well as tasks completed for each particular day.
- Some employees have not submitted leave forms.
- For the years 1998 – 2001, there was no segregation of duties between the preparation, and authorisation of payroll, authorisation and processing of EFT payments, as well as changes made to payroll.
- From June 2003 to September 2003 , the payroll was inappropriately prepared by a temporary employee without formal approval.

- The December 2001to February 2002 salary schedules for the SA employees could not be located.

Cause:

- Lack of adequate management review and attention to a significant element of SAEDF's operating costs.

Effect:

- Unauthorised salary adjustments and payments may have been made.

Recommendations

- SAEDF management should review and approve monthly payroll expenditure.
- SAEDF management must implement monthly personnel activity reports showing the distribution of activity for each employee. These reports must be related to employee compensation and fulfilment of their obligations, and signed by the employee and a knowledgeable supervisor.
- There must be an adequate segregation of duties relating to the preparation and processing the payroll, which must be authorised by the CFO or CEO. Management should take disciplinary action against staff that does not comply with the policies and procedures.

Management Comment

From 1998 to 2003 the South African and expatriate payrolls were prepared by the Financial Manager, approved by the Chief Financial Officer and paid by a payroll service provider. SAEDF forwards all earnings and deductions on a payroll spreadsheet to the service provider. The service provider calculates employee and company taxes, according to legislation, deducts them from the income and transfers the net salaries into the employees' bank accounts. In some instances SAEDF transfers the funds, but the process is as above. Payrolls were reconciled (expense accounts and balance sheet control accounts) on a monthly basis. The reconciliation's are prepared by the Financial Manager and approved by the Chief Financial Officer. All salary journals are prepared by the Financial Manager and approved by the Chief Financial Officer. At month end the Accountant and Financial Manager prepare a "Monthly control checklist". The list details various monthly processes that must be approved and reviewed. The Financial Manager reviews and signs for work performed by the Accountant, and the Chief Financial Officer approve and review the work performed by the Financial Manager. However, on review it appears that some of the checklists have not been reviewed by the Chief Financial Officer. Conversely SAEDF reviewed the payroll files from October 1997 to September 2003 and found the following:

  - Expense account reconciliations were performed for every month up to February 2002.

- Of these reconciliations the Chief Financial Officer or Financial Manager reviewed and signed all but 6 of them.

- Payroll schedules were available for every month from February 1998 to September 2003.

- The payroll clearing accounts were reconciled for every month from September 1998 to September 2002.

- Payroll journals were posted for every month, but 2, from October 1997. The journals were processed to reconcile the clearing accounts and expense accounts to the actual funds disbursed from the SAEDF bank accounts.

Management agrees that no employee activity reports have been used. However, staff attendance was monitored via leave schedules. Staff are required to submit leave schedules for prior approval to their departmental head. Once approved they are forwarded to the leave administrator to update the leave schedules. Leave days owed to staff are displayed on their monthly payslips. Excessive leave days taken, contrary to labour legislation, are deducted from staff pay. The system was reliant on staff honesty and integrity and there was therefore a possibility of manipulation.

The condition that there was no segregation of duties is incorrect (see condition 1 above).

Management agrees with condition 5.

Condition 6 is incorrect. Salary schedules are located in the payroll files and are also still kept by the Financial Manager in soft copy.

Management disagrees with the cause. Process detailed above shows adequate review, control and segregation of duties.

SAEDF's Chief Financial Officers previously approved all payroll reconciliations and journals, however since 2003 no Chief Financial Officer has been employed by SAEDF and the Financial Manager has therefore approved these. In the future the Chief Financial Officer or Chief Executive Officer (in the absence of a Chief Financial Officer) will be required to approve the payrolls. The Chief Financial Officer/Chief Executive Officer will also review the Monthly Control Checklist.

SAEDF is in the process of drawing up an employee review and compensation system. SAEDF will discuss, with USAID, methods of record keeping other than the employee activity reports.

Management deems the former system for preparing payroll satisfactory. In this system the Financial Manager prepares the payroll, Chief Financial Officer approves and a consultant processes. SAEDF has already advertised for the position of Chief Financial Officer and expects to fill the position as soon as possible.

KPMG Comment

Based on review of additional evidence it does appear that salary reconciliations between payroll and ledger were prepared and approved up to January 2002. The actual payrolls were however not approved. SAEDF could also not provide us with activity reports and attendance registers, the original finding thus remains.

1.7 CEO Benefits

Criteria:

- Paragraph 6 of the Grant Agreement states that no employee of SAEDF may earn more than US$150 000 per annum. The Grant Agreement also states that the salary limitation excludes reasonable benefits that are included in SAEDF's Personnel Compensation Policy.

- Paragraph 12 of the approved SAEDF HR policy manual states that non-South African nationals can obtain housing allowances, relocation expenses, travel allowances and similar forms of compensation provided that the compensation item is set at a reasonable level based on market circumstances and the general practices of other South African Companies.

- OMB Circular A-122, Attachment B, paragraph 7(g), states that the cost of automobiles that relates to personal use by employees (including transportation to and from work) is unallowable as a fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees.

Condition:

- There is no clear definition as to what are "reasonable benefits" in the Policy and Procedure Manual. We consider that benefits are unreasonable and unallowable for the following reasons:

    - During the years, 1998 – 2003, the CEO's had received a motor vehicle allowance, which is disallowed according to the Circular A-122.

    - During the years 1998 – 2003, the CEO's received housing allowances which may be excessive and not set at a reasonable level based on market circumstances.

    - A CEO received educational benefits for his children to the value of US$88 399.

Cause:

- Inadequate Board oversight to ensure compliance to the Grant Agreement.

Effect:

- Excessive allowances and benefits given to the CEO that were not market related.

Recommendation

- A formal *CEO Benefits Policy* should be prepared; reviewed and approved by the Board of Directors.
- This formal policy should be signed as evidence of approval, implemented and monitored by senior management.

Management Comment:

The SAEDF board, including USAID, approved a US$1,200 motor vehicle allowance for the Chief Executive Officer. The board also approved a US$4,000 housing allowance for the Chief Executive Officer. At the time the ZAR equivalent (+-ZAR 18,000) was deemed reasonable for the level of residential housing approved for the Chief Executive Officer. In latter years the devaluation of the ZAR increased the figure in ZAR-terms. The US$33,000 per annum education allowance was included in the contract for the employee in question when he was appointed to the position of Chief Operating Officer (January 2, 2001). It was unclear which year the allowance related to. Was it SAEDFs financial year, a calendar year or year from the Chief Executive Officer's contract inception? SAEDF, with consultation with the SAEDF board, decided to average the allowance over the Chief Executive Officer's contract (in other words it could not exceed US$66,000 for the life of his contract). The surplus amounts charged were unallowable and were part of the SAEDF counter-claim in the resulting lawsuit with the terminated Chief Executive Officer.

It is incorrect to state that there was no Board oversight.

Management agrees with the recommendations.

KPMG Comment

Additional evidence provided and the finding has been amended. The CEO's education allowance related to a two year financial period for 2001 and 2002.

No other additional evidence provided and finding remains.

1.8 Security for loan

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements states that the success of the Fund will be judged on the extend to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

In terms of paragraph 4.13 of the Loan Agreement between Ahanang Construction CC and the South African Enterprise Development Fund, Inc. Ahanang was to execute a bond over all movable assets in favour of SAEDF as security for the loan.

Condition

- There was no bond registered over the movable assets of Ahanang.

Cause

- Present SAEDF management were unable to state the reason for the bond not having been registered.

Effect

- SAEDF were left with no secured claim on the winding up of Ahanang and lost their full investment.
- The book value of the assets over which the bond was to be registered amounts to ZAR76,200, i.e. US$6,908 (assuming the same exchange rate as at disbursement date, i.e. US$1:ZAR11.03).
- Ahanang was wound-up and SAEDF has provided for the write-off of the full $89,622 investment.

Recommendation

- A control mechanism must be implemented whereby SAEDF ensures that security provisions of loan agreements are executed.

Management comment

The Chief Executive Officer approved the funding of "Social development" investments. These investments could not exceed ZAR1 million and could therefore be approved by the SAEDF Internal Investment Committee ("SIIC"), and ratified by the board Investment Committee telephonically. The approval process was shortened as the deals could be approved by the SAEDF Internal Investment Committee without extensive due diligence or a detailed board book. The deals did not need to provide SAEDF with the desired hurdle rate or 15%, only the original capital investment.

Management agrees with the recommendation.

KPMG Comment
No additional evidence provided, thus original finding remains. The controls in this area will improve if management implants our recommendation.

1.9 Redemption of shares

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extend to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

Condition

SAEDF's Board of Directors approved an investment in KSHL. SAEDF management were under the impression that the preference shares would be redeemed in US$. During the redemption process it was, however, noticed that the Investment Agreement stated that the preference shares would be redeemed in Zimbabwean dollars (Z$) and not in US$. The Z$ was already deteriorating in value at the time of the investment.

An Internal Discussion Draft, dated February 9, 2000, prepared by Mr. Jesse J. Spikes (Long Aldridge & Norman - LAN) and addressed to a former CEO, suggests that the redemption price of the shares was incorrectly changed from US$ to Z$ during the process of drafting the agreement.

Cause

- The investment associate succumbed to pressure from KSHL and, without proper authorization, changed the agreement in order to finalise the deal.

Effect

- SAEDF suffered a loss of US$646,308 as a result of the foreign exchange difference on redemption of the investment.

Recommendation

All changes made to agreements by the investment associates must be reviewed by the CEO or Senior Vice President in order to ensure that only authorised changes are made.

Furthermore, the CEO and Senior Vice President, Investments should be the only persons that may agree to changes in terms and conditions of investments on draft agreements, which must always be read with vigilance before signing.

Management comment

See investment responses.

KPMG Comment

No additional evidence was provided, original finding remains (see 1.32.2 in Appendix 3 for additional information).

1.10 SF -272

Criteria

- According to Enclosure 3 section F paragraph 1 (Reporting) of Grant Agreement.
  - SAEDF must submit an SF-272 "Federal Cash Transactions Report" within 15 working days following the end of each month. For the purposes of preparing SF-272s, SAEDF should report the use of Federal Grant funds only and be net of any income reflows.

Condition

For the period under review, the following period's SF-272s were not available:

- April 2003 to September 2003.
- August 2002.

For the period under review, not one of the SF-272s were ever completed and submitted within the 15day limit.

Effect

- Non-compliance to Annexure B section F paragraph 1 (Reporting) of Grant Agreement.

Cause

- Poor management or ignorance of Enclosure 3 section F paragraph 1 (Reporting) of Grant Agreement.

Recommendations

- Management should improve controls to ensure that SF-272s are provided within 15 working days after the end of each month by implementing a management checklist that needs to be signed off and reviewed on a timely basis in order to meet the reporting deadline.

Management Comment

It is agreed that SF272's have not been submitted since February 2003 and SF269's since June 2003. Management agrees that the returns were submitted after the 15th of the following month (see explanation below).

Management agrees that the returns were submitted after the 15th of the following month (see explanation below).

Management agrees that the returns were submitted after the 15th of the following month (see explanation below).

Management agrees with the auditor's cause statement.

Due to delays in receiving bank statements SAEDF Finance and Accounting department set the following monthly deadlines:

- 7th *of the following month* – closure of prior month,
- 10th of the following month – completion of trial balance, income statement and balance sheet (Accpac generated),
- 15th of the following month – completion of all journals, reconciliations and the monthly/quarterly reports.

In this way the SF-272 (and SF-269) would be prepared using final monthly figures, after reconciliations and corrections. These dates were communicated verbally to USAID who gave the indication that they were not concerned about the late submissions. The only stipulation at the time was that SAEDF would not be permitted to draw any funds down if the returns were not up to date.

In future management will "cut off" the processing of the month's transactions earlier than was previously done. In this way the financials will be finished earlier and therefore the SF272 would be submitted earlier. *It must be noted that this will lead to certain transactions* appearing in the incorrect month, thereby resulting in "over-" and "under-" provisions for certain expenditures. If possible management will post accruals for orders placed (per the completed purchase orders) but not yet paid for. The Monthly Control Checklist has been used since the 1997/8 financial year and will be reintroduced and enforced (with Chief Financial Officer/Chief Executive Officer review).

KPMG Comment

Additional evidence provided and finding has been adjusted.

1.11 Investment approval and disbursement

Criteria

In a document named "Understanding Venture Capital" prepared by SAEDF and included as page 48 of the staff handbook the following statement appears with regard to the length of time it takes for the investee to receive the funds:

"The amount of time from your initial contact until the time of a legal closing – when you receive money – can be as short as three weeks or as long as six months. The time involved depends on many factors. In general, the procedure takes six to eight weeks."

Condition

Eerste River Medical Centre (ERMC):

The time-line for the investment in ERMC was as follows:

- The investment application from ERMC was received on 18 February 1997.
- The Investment Committee of the Board recommended the investment for approval on 13 May 1997,
- The Board approved the investment on 14 May 1997.
- The funds were only disbursed on 13 August 1998.

The delay of 15 months in the finalisation of the investment occurred during mainly during the legal phase of finalisation, i.e. the drafting of the agreement. The agreement was revised and changed on many occasions.

SAEDF investment officials did not review the due diligence that had been performed at the beginning of the process.

Cause

The condition is due to there not being sufficient follow-up by SAEDF investment officials with regard to the legal progress of the agreement to ensure expediting.

Effect

ERMC's financial position had deteriorated significantly during the process of SAEDF's investment as a result of not having had the capital injection earlier. Accordingly, when the funds were received from SAEDF, they were not utilised for purposes initially intended, and ERMC subsequently went insolvent, resulting in the loss of SAEDF's investment.

Recommendation

- SAEDF must implement a control mechanism to ensure that the legal drafting and approval of agreements is completed promptly and due diligences conducted earlier (say six months before disbursement of funds) are re-visited.

Management Comment

See investment responses.

KPMG Comment

Original finding remains (see 1.29.1 for additional information).

1.12 Authorisation of bank transfer letters and cheques

Criteria

SAEDF's policies and procedures state that all local currency accounts of SAEDF should be signed by two persons. One person should be senior management as shown in Group A below and the other person should be the Vice Presidents as shown in Group B below.

- Group A – CEO, CFO
- Group B – Two selected Vice Presidents

Bank transfers shall also be authorised by two signatories from Group A and B above. At least one signature must be from a Group A member.

Condition

We noted several instances where the criteria above were not adhered to:

- In one instance, the bank transfer letter BT-2001-143 has been signed by two B signatories (MJ Moyo and A Buchanan). This bank transfer letter was dated November 7, 2001 (2002 financial year) and it was for $5,000.
- In an example, a cheque for $4,906 was reviewed where only one cheque signatory signed it.

Cause

SAEDF personnel were not aware of the policies with regards to the signatories that had to authorise bank transfers.

Effect

- Non-compliance to policies and procedures. This could have lead to unauthorized transfer of funds or theft of funds.

Recommendation

- SAEDF management should enforce adherence to policies and procedures currently in place.

Management comment

The bank transfer in question was a payment to the SAEDF appointed consultant for the USAID semi-annual review ("SAR") report. The consultant was appointed by the Chief Executive Officer and a contract was signed by the SAEDF Chief Executive Officer and the consultant - indicating reporting requirement and payment terms. SAEDF policy, if the regular "A" signatories are travelling, was that one of the "B" signatories not travelling was temporarily nominated as an "A" signatory. In this case the Vice President was nominated as the temporary "A" signatory and the Financial Manager the temporary "B" signatory. The instruction was signed by the Chief Executive Officer and forwarded to the banks. The payment therefore had the required Chief Executive Officer approval.

It is possible that the cheque was missed by one of the signatories and forwarded to the payee. However the bank in question was at fault if it paid the cheque, as it did not comply with the SAEDF standing instruction – that 2 signatories sign all cheques.

Management agrees that compliance with policies and procedures is essential but feels that this has been done and was done satisfactorily.

KPMG Comment

No additional evidence provided and finding remains.

2 Detailed Findings - Internal control issues – Material Weaknesses

2.1 Appointment of employees

Criteria

The capability/continuous-learning component of the COSO Control framework requires that organisations have a formal hiring and selection process to ensure that the most suitable individuals are selected for positions.

Condition:

For the years 1998 – 2003:

- There is no evidence that a formal interview process was in place for the appointment of new staff members. Thus, it is not possible to determine if the best possible candidate was selected for the respective posts.

  Examples are as follows:

  In 2002, a new Financial Manager was appointed but there is no evidence that indicates that other applicants were interviewed for the same position. In 2003, the Financial Manager was transferred to the Investment Department. It is questionable whether the ex-Financial Manager has adequate venture capital experience to perform the investment functions.

  It is apparent that certain staff members who were initially in the Finance department (2001 – 2002) had moved to the investment department, and they also may not have adequate experience in investments. The CEO's current PA and other staff have been appointed with no evidence of an interview process.

  During 2002/ beginning of 2003 most of the senior recruitment was done by the CEO and the Director responsible for HR matters, without the involvement of other senior staff members. During 2003 the current CEO did most of the appointments with no evidence of a formal recruitment process being followed.

Cause:

- Poor or autocratic management practices with subjective judgement.

Effect:

- The best possible candidate for vacancies may not be selected.
- New appointments may not have adequate qualifications, experience and skill to perform their daily functions, to the detriment of SAEDF.

Recommendations

- SAEDF management must implement formal and comprehensive HR policies dealing with consultative interviewing and selection processes, including verification of facts stated in prospective employees CV's.

Management Comment

Example 1 - SAEDF utilized a formal recruiting process for the majority of positions, until recently when SAEDF awarded an agency the sole mandate to recruit for SAEDF. Recruitment agencies were approached to forward candidates. The departmental head and the Chief Executive Officer interviewed the candidates and the most suitable candidate was eventually appointed. On certain occasions staff were promoted from junior positions or moved from other departments. Historically, SAEDF associates and analysts have always been recruited with accounting degrees. Vice Presidents and Senior Vice Presidents usually were required to have further qualifications (possibly an MBA).

Example 2 - The Finance and Accounting staff that moved to investments in 2001 and 2002 did so as their accounting systems and financial controls experience was deemed necessary to assist with turnarounds for certain SAEDF investee companies. A separate investment group was set up to monitor the "troubled investments portfolio".

Example 3 – Management agrees.

Management agrees with the cause.

Management agrees with the recommendation. Previously the potential employee verification was done by the recruitment agency, as SAEDF did not possess the necessary expertise.

KPMG Comment

No additional evidence was provided, finding remains. Should management implement recommendations as stated above the controls over appointment of employees will improve.

2.2 Design of policies and procedures - Travel

Criteria

The section relating to Direct controls in the COSO control model includes a requirement that policies and procedures should be put in place to provide guidance to staff regarding what procedures need to be adhered to. This will ensure that the control environment of the organisation is not compromised.

Paragraph 10 (travel expenses) of the SAEDF policies and procedures manual details the following regarding the authorisation for travel and accommodation,

- All officers of SAEDF will complete a travel form which includes,
  - Itinerary;
  - Period of travel;
  - Hotel arrangements;
  - Flight arrangements;
  - Any other relevant details; and
  - Duration of the trip.
- Travel forms should be completed and approved before the trip is undertaken.
- Where the travel expenses, was paid for using a credit card, the credit card statements must be authorised by senior management.

Attachment A of OMB CircularA-122 paragraph 3 details the following regarding Reasonableness of costs:

- A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. In determining the reasonableness of a given cost, consideration shall be given to:

  a. Whether the cost is of a type generally recognized as ordinary and necessary or the operation of the organization or the performance of the award.

  b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.

c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.

d. Significant deviations from the established practices of the organization, which may unjustifiably increase the award costs.'

Attachment B Circular, A-122 paragraph 18 details the following regarding Goods or services for personal use.

- Costs of goods or services for personal use of the organisation's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

Condition

SAEDF policies and procedures contained deficiencies, which detract from good internal control and during the review of the expenditure accounts the following was noted:

- The policies and procedures manual does not specify that airline tickets should be attached to the pack of travel documentation when claims are submitted.
- SAEDF travel policies were also not always adhered to i.e. all the relevant approved documentation was not available, and per diem rates paid were excessive.
- For travel undertaken by employees and officers of SAEDF, some of the trips undertaken did not have a travel form and the necessary documentation as is detailed in the policies and procedures manual.
- In some instances travel forms were dated after the trip, or the travel form was not authorised at all.
- Travel authorization forms were sometimes approved by employees on the same staff level as the person travelling.
- Credit card statements for travel expenses were not authorised by senior management.
- The executive assistant / office manager took various trips that did not appear to be required.
- In certain isolated instances there were unreasonable or prohibited expenses, e.g. purchase of alcohol, business class travel, entertainment costs not complying with Circular A-122 etc.
- Expenses considered to be wasteful were paid for "No Show" charges at the Westcliff Hotel.

Cause

- Poor design of Policies and procedures manuals with regard to travel and lack of compliance to such policies.

- Poor management review or wilful non-compliance to the SAEDF policies and procedures

Effect

- As travel forms detailing all the information concerning the trip were not always completed, adequate control did not exist over travel undertaken by employees. Employees may have travelled unnecessarily or for private reasons and this expense may have been borne by SAEDF.
- Adequate authorisation did not exist for travel undertaken by employees and officers of SAEDF.
- Non-compliance with Circular A-122 resulting in questioned costs of being raised.
- Unreasonable / excessive travel expenditure borne by SAEDF.

Recommendation

- The policy and procedures manual for travel must be amended to include all the requirements discussed in the conditions above.
- SAEDF management must ensure that it's amended policies and procedures relating to officers and employees' travel and per diem payments, are strictly adhered to.

Management comment:

This statement is partially correct. In later years staff were required to attach the air ticket stub and/or the boarding pass. It was decided by Finance and Accounting that the air ticket was no guarantee that the flight had actually been taken and therefore the boarding pass had to be attached to the claim. The policy was also reliant on SAEDF Finance and Accounting department common sense e.g. if a hotel bill from the SADC country travelled to was attached to the expense claim then it was obvious that the person had taken a flight, or if 2 staff members travelled together and one had misplaced his ticket stub then it was not insisted upon for that person if the travel details were confirmed by the other. Management also reviewed all travel requests prior to departure (via the travel authorization form) and payments after returning (via the monthly/quarterly management reports).

Each investment group PA, as well as Finance and Accounting, kept copies of all travel forms. On inspection it was discovered that some forms were missing. It is not clear which per diems the auditors regard as excessive as the rates were strictly adhered to. It is possible that per diems for accommodation may have been approved if the trip was urgent and no cheaper accommodation was available. To management's knowledge no trips (excluding board meetings) were approved where the lodging per diem was above the Policies and Procedures maximum allowable rate.

In very few instances investment staff were required to travel with little or no notice. The trips were verbally approved by the Vice President/Senior Vice President and when the PA had the opportunity to complete the form it was completed and forwarded to the department head for signature. Senior management received a detailed monthly report (Accpac and management report) showing the business trips taken during the period. Had a trip appeared that the Chief Financial Officer and Chief Executive Officer never approved then they would have queried the trip during their management meetings.

SAEDF cannot comment on the charge without reviewing the relevant documentation.

In the past SAEDF credit card policy did not require senior investment managers to approve statements. The person who used the card attached all vouchers and signed the statement as acceptance of the itemized expenses. The senior manager would then review the statement, vouchers and charges. He would discuss questionable expenses with the employee and deduct any unresolved expenses from the expense claim. Management agrees that the manager should have been required to sign the statement too to indicate his approval. SAEDF will enforce this in future.

Management agrees with condition 7. However, this and other Chief Executive Officer expenses, were queried by Finance and Accounting and were highlighted to the auditors during the subsequent internal audit.

It is understood that the charge/trip in question relates to the Chief Executive Officer during 2002. It could not be established why the London expenses were paid for by SAEDF. However these expenses were queried by Finance and Accounting and were highlighted to the auditors in detail during the internal audit.

Purchase of alcohol was approved by the SAEDF board (only for business-related meals) and was to be deducted from non-grant funds. All movies and other non-business expenses incurred during SAEDF travel were deducted from the M&IE advance paid to the staff member, and therefore effectively paid by the employee.

Management agrees that the no-shows were unfortunate. However, the organizing of the SAEDF board meetings has always been extremely difficult. SAEDF board members occasionally cancel their attendance at SAEDF board meetings, due to various reasons, resulting in SAEDF having to pay for the room/s.

SAEDF regards their travel policies as satisfactory. However, the additions to the existing policies that SAEDF adopted informally should have been formally incorporated into the policies and procedures manual (instead of via e-mail or internal memorandum).

Management agrees with cause 2.

Management and the SAEDF board identified the need to review the internal controls and was one of the reasons for appointing an internal auditor in 2002. It is agreed that the travel policies and procedures should be constantly reviewed and updated. Management also agrees that the new Chief Financial Officer will be tasked to improve these areas of concern.

Management agrees with recommendation 2.

KPMG Comment

No additional evince provided to indicate that weaknesses do not exist in the design of Travel policies and procedure. The original finding remains.

2.3 Completion of policies and procedures – Human Resources

Criteria

The section on Commitment and Capability/continuous learning in the COSO model requires that organisations need to have clear guidelines regarding:

- Performance contracts and evaluation criteria.
- Performance evaluation systems.
- Motivation/reward/punishment mechanisms.
- Reward systems.
- Training activities and processes.
- Hiring and selection processes.
- Termination practices.

Condition

After inspection of SAEDF's HR policy and procedure manual, it was noted that the policy was not complete and accurate in that it neglects to address the following issues:

- No set format and process on how performance appraisals should be completed.
- No guidelines with regards to the definition of "reasonable benefits and allowances".
- No maximum amount of allowances that should be awarded to the CEO.
- No clear guidelines on training.
- No clear guidelines on recruitment processes.
- No adequate guidelines on termination process.

Cause:

- Poor management practices with insufficient thought being given to internal controls.

Effect:

- This negatively impacts on the control environment of SAEDF as well as on staff performance and morale.

Recommendation

- SAEDF should enhance its existing human resources policies and procedures in the above-mentioned areas.
- SAEDF management must draw up clear best practice performance appraisal procedures, which must be applied fairly and consistently, to all employees.

Management comment

Although SAEDF previously conducted personnel reviews it is agreed that the policy should have been more extensive and formalized. Certain decisions that were taken by management should have been included in a formal policy. SAEDF management is currently implementing a formal appraisal and remuneration policy/system, which will rectify the issues mentioned by the auditors.

Management disagrees that the use of informal appraisal and recruitment processes can be regarded as "poor management practices".

Management agrees with the recommendations. Management is currently in the process of implementing this and should have the processes in place within the next six months.

KPMG Comment

No additional evidence was provided and finding remains.

Management agrees with recommendations stated above and the controls over Human resources policies should improve if these recommendations are implemented.

2.4 Design of controls - Bank Transfers & Authorisation limits

Criteria

- The Grant Agreement requires SAEDF to manage its operations to achieve its investment objectives. To achieve this, internal controls must be designed and implemented, including guarding against the risk of fraud.

Condition

- SAEDF had often instructed Banks to make payments into third party accounts. This was done by means of sending faxes to the Bank, which was not required to confirm the faxed instruction with a senior Fund official. There have been instances of fraud at other organisations where fictitious faxes were used to instruct banks to transfer funds.

Cause

- Poor management practices and insufficient thought given to the risk of fraud.

Effect

- SAEDF is exposed to the risk that fictitious faxes could be sent, leading to monies being misappropriated.

Recommendation

- A request should be made to the Bank to confirm all payment transfer faxes with the CFO before releasing the payment or SAEDF should consider changing payment methods i.e. use of Electronic Funds Transfer.
- SAEDF's policies and procedures should be changed accordingly i.e. use of EFT to process payments or completing weekly bank reconciliation's and the relevant board and USAID approval should be obtained.

Management comment

Incorrect auditor condition. SAEDF adopts the same mandates with regard to bank transfers as it does with cheque payments. SAEDF requires all bank transfers to be signed by 1 "A" signatory and 1 "B" signatory. Prior to sending the fax all bank transfers are reviewed by the Financial Manager (who initials and dates the back of the transfer letter).

The example of fraud that Auditors mention did in fact occur at SAEDF in 1999. The error was detected by Finance and Accounting the following day and the staff member was subsequently dismissed. The fault was not an SAEDF error but an American Express error as they failed to comply with the SAEDF signature mandates and issued foreign currency to a junior employee (who was not even a signatory).

Management disagrees with recommendation 1. It is impractical to suggest that SAEDF's banks confirm all transfers, especially as SAEDF also makes payments from a US-based bank.

SAEDF management did consider the use of Electronic Fund Transfers ("EFT") but at the time it was decided that their use was still risky and SAEDF decided to continue with its existing system of cheques and bank transfers. Management has reviewed the use of EFTs and has received board approval to effect EFT payments.

KPMG Comment

We still believe that sending fax documents to banks to instruct them to make payments into third party accounts is high risk, as fax documents may be easily tempered with resulting in invalid payments.

Should management decide to use EFT payments with the relevant EFT controls, this will help reduce the risk with regard to payments.

2.5 Disaster recovery plan

Criteria

The planning and risk assessment section of the COSO control model requires that disaster recovery procedures and contingency planning be implemented in organisations, to ensure that the organisation is adequately prepared in the event that a disaster occurs. This plan would include the backing up of information on a regular basis and storing these backups offsite.

Condition

- The backed up computer information data is stored on SAEDF's premises and not off-site.
- No backed up data was available for the financial years of 1997 and prior.

Cause

- Management's lack of security awareness in carrying out their stewardship responsibilities.

Effect

- SAEDF is exposed to the risk of losing data and records with an adverse affect on business operations.

Recommendations

- SAEDF management must develop a comprehensive disaster recovery plan, which deals with the safeguarding of its data, records and property. Such a plan must be implemented and regularly tested.

Management comment

Management agrees with condition 1. The SAEDF server is backed up daily and tapes are supposed to be taken by the Office Manager offsite each day. On investigation it was discovered that the Office Manager had failed to do a few backups and also failed to take the backup tapes offsite. The Office Manager was subsequently verbally warned and informed of the potentially serious consequences of his actions/inactions.

Management agrees with condition 2. SAEDF did not have any form of disaster recovery in 1997 as all admin and accounting was outsourced to Deloitte and Touche. SAEDF subsequently contracted the services of an IT consultant to install, monitor and update all of SAEDF Information Technology.

Management understands their security responsibilities but the decision to task the Office Manager with the responsibility was possibly an error. Management will institute review of the backup procedures by a senior official.

Management agrees with the recommendation.

KPMG Comment
No additional evidence was provided, finding remains. Should management implement recommendation above the controls over disaster recovery will improve.

2.6 Personnel Documentation

Criteria:

The commitment section of the COSO control model requires that:

- Performance contracts are kept for all staff.
- Job descriptions are in place for all employees.

Condition:

- There was no formal HR policy and procedures with regards to personnel file documentation.
- For the years 1998 – 2003, there were no employee files for some employees. (See below).
- For the years 1998 – 2003, there was a lack of documentation in some employee files, for example we could not locate contracts, job descriptions and curriculum vitae's in certain instances.

The following summarises the condition:

Details	1998	1999	2000	2001	2002	2003
Number of employees in 1998/Number of new employees in 1999 – 2003	32	8	18	4	7	8
Percentage of employees that did not have employee files	34 %	38 %	22 %	0 %	14 %	25 %
Percentage of employees that did not have employee contracts	42 %	38 %	39 %	25 %	14 %	50 %
Percentage of employees that did not have job descriptions	42 %	38 %	56 %	100 %	29 %	100 %

Cause:

- Poor management oversight and attention given to personnel files.

Effect:

- Lack of complete employee files makes it difficult to control amounts paid to employees and resolve discrepancies that arise.

Recommendation

- SAEDF management must formulate an HR policy requiring minimum documentation to be maintained in employee files, and procedures to ensure that this is complied with.

Management Comment:

Management agrees with condition 1. No specific personnel information was required in the past, except for a copy of the employee's employment contract. Management will incorporate a list of specific documentation requirements into the new HR Manual.

Condition 2 is incorrect. On review of the personnel files employee files were present for all SAEDF past and present staff. It must be mentioned that the current Finance and Accounting staff had not adequately safeguarded the files and had misfiled numerous documents. The documentation has since been re-filed and is kept in a locked office.

Management agrees with condition 3. Finance and Accounting have completed updating the employee files for all current and past SAEDF staff. Numerous job descriptions and curriculum vitae's were found and filed in the appropriate files. Updated job descriptions will be included as part of the updated HR process currently being undertaken.

Management agrees that the recent Finance and Accounting staff have not adequately administered and safeguarded the personnel files. This error has since been rectified.

Management agrees with the recommendation. SAEDF management is currently undergoing an HR review and will incorporate the recommendation regarding required documentation as stipulated by labour legislation.

KPMG Comment

No additional evidence was provided, finding remains.

2.7 Income: Equity accounting

Criteria

Section 2.2 of SAEDF's accounting policies state that investments should be included in SAEDF's financial statements using the Equity method of accounting.

Condition

- SAEDF does not use the Equity method of accounting for recording investments.

Cause

- Management were of the opinion that Equity accounting of investments would be misleading due to nature of the investments.

Effect

- SAEDF's accounting records are not compliant with GAAP (generally accepted accounting practice).

Recommendation

- SAEDF's Policy and procedure manual must be updated to state that the results of investees need not be equity accounted. To be valid, the Board must seek and obtain USAID's approval for this change.
- SAEDF must change their accounting procedures to conform with their policy or change their policy to conform with their procedures with regard to the method of accounting for investments.

Management comment

The issue was raised in prior years by SAEDF's external auditor. It was management's decision that the use of equity accounting would be misleading as, at the time, the majority of SAEDF's investments were early stage or start-ups. These entities were virtually all loss making and to include these losses in SAEDFs financials did not make sense. SAEDF decided to adopt the European Venture Capital Association ("EVCA") guidelines for valuing early stage investments at cost. As the annual financial statements were unqualified and signed by the external auditors implies that they were in agreement with SAEDFs view.

Management agrees with the cause (as above).
Management agrees that the SAEDF Policies and Procedures should be amended.

KPMG Comment

No additional evidence was provided, finding remains.

2.8 Authorisation of expenditure

Criteria

Paragraph 6 (accounts payable) of the SAEDF policies and procedures manual states the following:

- Invoices must be reviewed by a person independent of the person who requisitioned the purchase.
- For expenses to be paid a cheque requisition must be completed and the approved purchase order and original invoice must be attached to the cheque requisition.
- Once an invoice has been paid the package of documents containing the cheque requisition, purchase order and original invoice should be stamped "paid" to avoid duplicate payment.
- Purchase orders for the procurement of services and supplies shall be raised by the various section heads.
- All orders shall be routed to the CFO for certification of availability of funds against the budget and approved by the CFO, according to his approval limit.
- The following approval limits are detailed:
  - ➢ Chief Executive Officer $50,000
  - ➢ Chief Financial Officer $30,000
  - ➢ Investment Officers/Directors $5,000
- Should expenditure in excess of the predetermined limits be incurred, this is to be authorised by the Chairman of the Board and ratified at subsequent Board meetings.
- The SAEDF policies and procedures manual also details the following with respect to the obtaining of quotations,
  - ➢ Orders less than $3,000 require one quotation.
  - ➢ Orders greater than $3,000 but less than $30,000 require three quotations.
- Orders greater than $30,000 require approval by Contract Committee comprised of four senior managers. The composition of the committee will be periodically reviewed.

OMB Circular A-110 section 43 and 44 on Procurement standards state that all procurement should be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interests as well as non-competitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade.

Paragraph 10 (travel expenses) of the SAEDF policies and procedures manual states the following:

- All American Express / Nedbank / Diners Club credit card holders are required to allocate the costs reflected in the statement to specific business related activities. Once the costs have been allocated the statements must be authorised by either the CEO or the CFO.

According to sound business practices and VAT legislation expenses should only be paid on original documentation, i.e. invoices.

Condition

During the review of the expenditure accounts it was noted that:

- Invoices were not reviewed by a person independent of the person requisitioning the purchase. It was not clear who had requisitioned the purchase, as there were no purchase orders.

- No purchase orders existed for the majority (80%) of the transactions tested.

- For approximately 90% of documentation examined, including the expense claims forms, the original invoice, the supporting documentation and the cheque requisition was not stamped "paid" to prevent it being resubmitted for payment.

- In instances where purchase orders were found, approximately 25% of the purchase orders, reviewed were not approved by any senior officials. It was thus not possible to determine if the purchase orders were valid.

- Approval limits were not adhered to i.e. there was no evidence of approval in terms of the approval limits listed above.

- There were no quotations obtained for the majority (80% to 90%) of the expenses tested whereby quotations are required to be obtained.

- There was no evidence that a formal supplier selection process was being followed.

- There was and currently is no contract committee in place.

- There was no evidence of a tender process being done to appoint service providers and thus no evidence of there being competition.

- There is no evidence of formal monitoring of service providers as there are no contracts and service level agreements with chosen service providers (travel agents, legal services, consultants and recruitment agencies)

- There was no evidence that credit card statements were authorised in majority of the transactions examined. Credit card balances were paid directly through debit order.

- Of the transactions examined 75% of the credit card statements reviewed did not contain an allocation of expenses to specific business related activities.
- There were instances where expenses were paid on copies of invoices.
- In some instances (25%) the purchase order date was after the invoice date.

Cause

Ignorance and/or wilful non-compliance to Paragraph 6 of the SAEDF policies and procedures.

Poor management review of SAEDF policies and procedures

Effect

- As no approved purchase orders existed for most of the transactions there is no evidence that purchases made where valid.
- As the package of documents is not stamped "paid", this may have resulted in duplicate payments being made.
- As the approval limits for authorisation of expenditure detailed in the policies and procedures manual are not adhered to the possibility exists that goods and services, which are overpriced or invalid, may have been be procured.
- As there was no Contract Committee in place the procedures that are required by the SAEDF policies and procedures manual have not been adhered to with respect to orders greater than US$30 000 obtaining Contract Committee approval.
- As no quotations were received and no tender process for contracts or monitoring of service providers, SAEDF may not have received the best quality of service at the most competitive price.
- As credit card statements were not authorised, payments may have been made for invalid expenses.
- As credit card expenses were not allocated to specific business related activities, specific expense accounts could be misstated resulting in an inaccurate analysis of SAEDF's expenditure.
- Unauthorised expenses may have been incurred.
- This impacted on segregation of duties and may have resulted in goods and services procured being used for non-Fund purposes.
- Payment of expenses on copies of invoices may have resulted in duplicate payments and invalid VAT claims.

Recommendation

- SAEDF management must ensure that it's policies and procedures relating to procurement approval levels, the obtaining of quotations, approval, entering into contracts and service level agreement with service providers and monitoring of contracts are strictly adhered to.

Management Comments

The person requisitioning the purchase has to be the person who signs the invoice, as his signature on the invoice is evidence of his acceptance of the good/service. There is sufficient segregation of duties, as the person requisitioning the order does not approve the requisition. The second segregation of duties occurs when the Financial Manager or Chief Financial Officer signs the purchase order. The SAEDF Procurement Manual details the segregation of controls extensively. SAEDF did complete purchase orders for disbursement and is incorrect to state that there were none found.

Incorrect. On review it appears that the relevant purchase requisitions and orders had been detached from the cheque requisition/bank transfer and filed in a separate file. Management agrees that in the 2003 financial year the use of requisitions and orders was not enforced. In addition the budget control sheets, which determine if the budget will be exceeded prior to disbursement, were not utilized at all.

Accpac accounts payable has a feature that prevents an invoice number from being entered more than once. Monthly accounts payable reconciliations (Accpac to creditor statement) were performed, and reviewed. A further safeguard was that SAEDF did not make payments on copy tax invoices. If an invoice was misplaced SAEDF would reconcile the account to confirm that the payment had not been processed before. In the case of non-accounts payable payments Finance and Accounting would review the cheque and bank transfer registers to confirm that no prior payment had been made. To SAEDF's record only 1 duplicate payment occurred in the entire 6 year period and it occurred before SAEDF had a full-time accounting department and a fully functioning Accpac accounting system. Extensive controls have been implemented since this time.

SAEDF's policy requires that all purchase requisitions be approved by a senior official/head of department. Nevertheless it is possible that the auditors reviewed the purchase orders, not the purchase requisitions. The Procurement Manual identifies the purchase requisition as the document that approves the purchase, not the purchase order.

SAEDF complied with the approval limits. Should the auditors indicate the purchases where approvals were not adhered to SAEDF will in turn respond.

Quotations were either written in the space provided on the purchase requisition, or were attached to the purchase requisition. It appears that the purchase requisitions and orders have been detached from the payments, and therefore so have the quotes.

The supplier selection process was not formalized and was the responsibility of the Office Manager. If any staff member was unhappy with the service offered by the vendor the Office Manager would approach them to discuss the accusation or change to another supplier. As most of the selection process was verbal it is accepted that the process should be formalized.

SAEDF decided to replace the Contract Committee with the Office Manager. At the time the size of the organization as well as the low number of monthly vendor transactions made the Contract Committee impractical. Management at the time decided that the tasks of the Contract Committee would be better handled by the Office Manager.

The vendor tender process was adhered to, however SAEDF management instructed the Office Manager to use vendors owned by previously disadvantaged citizens (BEE). It was managements view that SAEDF's mission was also to help these companies "get off the ground" and would therefore give them a higher "weighting" in the tender process. In this way it is true that competition was reduced.

In the years 1998-2002 SAEDF did sign service contracts with certain vendors (excluding legal). The contracts were filed in the SAEDF "contracts file". If any staff member was unhappy with the service offered by the vendor the Office Manager would approach them to discuss the accusation or change to another supplier. When a service provider was used for a single assignment a copy of the contract was attached to the payment. SAEDF has since reviewed the file and certain documents were missing, while other documents have since been found.

The procedure was that staff attached all vouchers to the original credit card statement, while Finance and Accounting allocated the expenses on the copy statement. On review it was discovered that the files have been altered and many signed credit card statements (originals) have either been mispiaced or misfiled. The approval of credit card statements was a constant problem due to the lack of assistance Finance and Accounting received from the other SAEDF department heads. SAEDF contends that the policy was satisfactory, but adherence was not what it should have been. SAEDF is currently reviewing the filing and controls relating the credit card transactions.

All staff were required to physically identify business and personal expenses on their credit card statements as well as on vouchers. SAEDF policy at the time was to allocate all expenses on the copy statements and attach all vouchers to the original statements. The original statements were then signed by the employee and reviewed by the department head. It appears that the misfiling of these statements/documents is a result of recent SAEDF staff not understanding the process and therefore incorrectly altering the filing system. Although SAEDF feels the figure is well below the 75% mentioned by the auditors Finance and Accounting is currently reviewing the filing and controls relating the credit card transactions.

As a rule, SAEDF did not make payments on copy tax invoices. However, if an invoice was misplaced SAEDF would reconcile the creditor account to confirm that the payment had not been processed before. If the payment was urgent and an original tax invoice was to be posted on payment then the payment was filed in the "payments awaiting original invoices" file. This file was reviewed every time payments were made.

Purchase order dates were occasionally after the invoice date due to the non-compliance with the policy by the staff preparing the purchase requisition or order. To trace the staff member who had failed to follow the procedure each department Personal Assistant was given a sequentially numbered requisition and order books. Non-adherence to the policies could be traced via the requisition/order number and the offending Personal Assistant was reprimanded. The fault in the process was that the heads of these departments failed to insist on compliance with the policies (and were sometimes the offenders) and therefore undermined the process.

Management contends that the policies are satisfactory, but as with any system of control it is ultimately reliant on the staff in the process. Resistance of the staff to the process was a direct result of the failure of SAEDF's other (non Finance and Accounting) senior managers to enforce the process in their own departments. However, the failure to adhere to the policies was an exception, rather than the rule.

Management agrees with the recommendation, and feels that the policies should be formally reviewed and updated. Once complete the SAEDF board and USAID approval will be obtained. Of considerable confusion is that the updated Policies and Procedures manual was presented to the SAEDF board (incl. USAID) in 2001 and according to SAEDF management's understanding was approved. However, it appears that the approval was either not granted or not recorded. Had the document been approved it would have eliminated a large portion of the misunderstandings created in the audit.

KPMG Comment

SAEDF policy manual states that invoices must be reviewed by a person independent of the person who requisitioned the purchase. Until such time as the policy manual is changed and approved by the board and USAID the existing policy manual should be adhered to.

The files of additional evidence provided to us did not contain purchase orders or purchase requisitions. We were however shown booklet's of copies of purchase orders/requisition which seem to indicate that they were prepared in the past. We were however not provided with specific purchase ordrer's/requisition for expenses reviewed, and thus can not say that purchase orders were always completed. Our original finding remains.

2.9 Bank Reconciliation's: 1998 - 2003

Criteria

According to section 5.3 of SAEDF's Accounting manual, reconciliations between the cashbook and the bank accounts should be performed periodically but not less then once a month. The reconciliation's will be subject to regular review by the CFO and periodic review by the CEO.

Condition

For the years, 1998 – 2003, no authorised bank reconciliations were available for some month's bank accounts, as follows:

- For the years 1998, 1999, 2000 and 2003, certain bank reconciliations were not reviewed by the Financial Manager or CFO.
- The reconciliation's were also not periodically reviewed by the CEO.

Cause

- Wilful negligence on the part of management with regard to lack of review of bank reconciliations.

Effect

- The integrity of bank reconciliations not reviewed is in questioned and the possibility of irregularities cannot be ruled out.

Recommendation

a. SAEDF management must ensure that Bank reconciliations are adequately safeguarded.

b. Improved policies and procedures that would commit SAEDF management to ensure that all bank reconciliation's are reviewed by the CFO and periodically reviewed by the CEO.

Management comment:

Bank reconciliations were performed monthly. The recons were performed by the accountant and reviewed by the Financial Manager. The Chief Financial Officer used to randomly sample/review the recons. At month-end the Bank Reconciliation checklist, and a Monthly Control Checklist, were initialled by the Accountant. The Financial Manager would then review the bank recons and sign the Monthly Control Checklist. The signed Monthly Control Checklist was attached to the monthly Internal Management Report or the quarterly Treasurer's Reports for review by the rest of SAEDF management (Monthly and Treasurer's Reports) and the SAEDF board (Treasurer's Report only).

A review of the SAEDF bank reconciliations showed that the above procedures were adhered to for a vast majority of the period in question.

The bank reconciliations were never reviewed by the Chief Executive Officer. Only the Chief Financial Officer reviewed the recons (on a periodic basis).

A historical schedule of monthly checklists and bank reconciliations shows that management complied with the processes almost all of the time, but the maintenance of records was lacking.

Management agrees that bank recons should be safeguarded and steps will be taken to ensure this.

Management does not feel that it is necessary for the Chief Executive Officer and Chief Financial Officer to review bank recons. Once the Chief Financial Officer is appointed he will periodically review the bank recons performed by the Accountant (and primarily reviewed by the Financial Manager).

KPMG Comment

No additional evidence provided to indicate that bank reconciliations were done for all the months in question. The issue with regard to CEO reviewing the bank reconciliation may be valid but section 5.3 of SAEDF policy requires this. Should this not be practical, the Accounting manual should be changed and approved by USAID and the board.

2.10 Conflict of interest

Criteria

Section 10 of Enclosure 3 to the Grant Agreement states that where any director of SAEDF is a director or has a financial interest in any other organisation with which SAEDF has entered into, or has considered entering into, any agreement, grant or other transaction, such director ***shall disclose in writing to the Board of Directors*** all material facts as to his/her relationship or interest. Such director shall, furthermore, be recused from any participation of the Grantee with respect to such contract, grant or other transaction.

Condition

A Board member of SAEDF, was one of the shareholders of Babete. The Director's interest was noted in the Directors meeting on 20 June 2002 where the investment was discussed, the Director was not present during the discussion.

The Directors requested that they be presented with a full written description of the director's involvement with the Maxiprest group. The director did not submit a written declaration of her involvement in the proposed transaction.

Despite the director's interest in the contract, the Director subsequently participated in negotiations relating to the Maxiprest investment, with SAEDF management.

Cause

- The contravention of the criteria is due to SAEDF management and the relevant Board member disregarding the request from the Board of Directors.

Effect

- The condition results in SAEDF being in contravention of the Grant Agreement and the relevant director not fulfilling his/her fiduciary responsibility as a director of SAEDF.

Recommendation

- SAEDF management and Board of Directors should institute and monitor clear Human Resource policies relating to conflict of interest. Such policies should not only require disclosing conflicts of interest but also require refraining from participation in activities in which there is a conflict of interest. Strong action against Board members who do not fulfil their responsibilities should be taken.

Management comment

Management agrees. The director gave full verbal disclosure of her interest in the transaction. The board instructed the Chief Executive Officer to obtain the written disclosure, which he failed to do. His services were terminated, in part, as a result of this transaction.

The auditor's cause is therefore incorrect.

Management agrees with the recommendation. However, these policies are already in place for directors and staff. The case in question was a result of the Chief Executive Officer not complying with board instructions, not a lack of a formal policy.

KPMG Comment

No additional evidence provided, original finding remains.

2.11 Maintenance of records

Criteria

Section 2.A of Enclosure 3 to the Agreement states; "The Grantee shall maintain books, records, documents, and other evidence in accordance with generally accepted accounting practice. The Grantee's financial management system shall: (i) provide for accurate, current, and complete disclosure for each Grantee-sponsored activity; (ii) identify adequately the source and application of funds for all Grantee-sponsored activities, and (iii) enable the Grantee to accurately determine Grant balances, book balances and reconciliation of book to Grant balances."

Section 2.A of Enclosure 3 to the Grant Agreement states that "All investment and related business documentation concerning investees, periodic financial statements of investees and (if prepared) audits of investees received by the Grantee shall also be maintained for audit review and project monitoring."

Section 2.D of Enclosure 3 to the Grant Agreement further states that "All investees will be required to prepare periodic financial statements..."

Section 286 of the South African Companies Act no. 61 of 1973 states "The directors of the company shall in respect of every financial year of the company cause to be made out in one of the official languages of the republic, annual financial statements..."

Condition

The following conditions were noted:

Eerste River Medical Centre (ERMC):

There were **no signed audited financial statements** on file for ERMC for the financial years ended 30 September 1999 and 30 September 2000 even though SAEDF had invested $900,000 in ERMC.

Vantaris Capital Fund (VCF):

The following payments to VCF, as per the general ledger, could not be traced to the bank statements for the iAfrica Investment Account, due to the bank statements not being on file:

General ledger entry date	Amount – $
7 April 2000	$27,333
31 January 2001	$21,277
6 July 2001	$19,726
Total	**$68,336**

The approved journal voucher (9/34) and supporting calculations relating to the provision for the write-off of the investment in VCF for the amount of $9,927 was not in the journal file.

Cause

- ERMC did not provide SAEDF with the required financial statements.
- Lack of approved, supporting documentation and bank statements for disbursements/provision in VCF.

Effect

- Without the signed audited financial statements of ERMC, SAEDF was hindered from adequately monitoring the financial performance of ERMC.
- Without the supporting documentation, it is not possible to substantiate the disbursements/provision in VCF.

The following amounts are questioned as ineligible or unsupported costs:

Investment	Questioned cost (US$)
ERMC	$900,000
VCF	$78,263

Recommendation

- SAEDF should implement a control mechanism that will ensure that all financial statements are obtained from investees and that all documentation is filed and safeguarded.

Management comment

See investment responses.

KPMG Comment

Management have provided us with evidence that they were requesting financial statements from ERMC, who eventually provided some draft financial statement but no audited financial statements were provided. The original finding remains.

2.12 Due diligence process

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures, was approved by the SAEDF Board and the USAID Grants Officer.

The Guidelines for Review of Financial Intermediaries (due diligence), which is incorporated in the above-mentioned SAEDF Investment Policy, Guidelines and Procedures Manual, includes the following with regard to assessing the condition and merit of an investee company:

- Organisation and management
  - Assess the organization's decision-making processes, including review board and committee minutes for purposes of assessing the quality of management's supervision.
  - Review the managerial and organisational structure as well as the reporting mechanisms utilised by the investee company.
- Operations
  - Assess adequacy of the investee company's operations and internal controls.
  - Determine the adequacy of the investee company's record keeping, financial accounting and management information systems.

Condition

Maxiprest/Babete

The due diligence for the investment in Maxiprest was conducted after the initial investment of $825,265 had already been made.

Pick-a-Spaza (PASH):

SAEDF invested $1,023,109 in PASH. The due diligence performed on PASH by the SAEDF was superficial and did not address key issues.

TV Africa:

The initial due diligence performed by SAEDF was not adequate, as it did not identify areas of concern, which were identified 4 months after disbursement. Furthermore, the SAEDF staff involved in the due diligence did not undertake sufficient research relating to the amount of capital injection that is needed for a television network.

Cause

- SAEDF investment associates either did not perform an adequate due diligence to identify areas of concern or they ignored areas for concern identified during the due diligence process.

Effect

- SAEDF incurred losses on investments as a result of inadequate due diligence.

Recommendation

- All due diligences performed must be based on an approved audit programme to be drawn up by SAEDF management. This will ensure that all the required information is obtained. Once the work and report have been completed both should be reviewed by a person independent of the due diligence team.

Management comment

See investment responses.

KPMG Comment

Additional evidence was provided and finding has been adjusted. Insufficient audit evidence provided for issues listed above and these findings remain.

2.13 Monitoring of investment

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires, amongst other things, that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

Discussions with other venture capital organisations indicate that monitoring is one of the critical elements in the industry and best practice monitoring includes the following:

- Telephonic conversations with investees on a weekly basis
- Monthly monitoring meetings with key role players (these meetings get documented).
- Obtaining monthly management accounts from investee companies.
- Obtaining annual audited financial statements from investee companies.

Condition

The following instances of poor monitoring were noted:

Ahanang:

It appears that monitoring was done on Ahanang, but further funds of $ 34120 were invested in Ahanang after results of monitoring had raised concerns about Ahanang.

Eerste River Medical Centre (ERMC):

SAEDF did not monitor the financial position of ERMC or the strategies put in place by it's promoters to achieve the forecasts given in the due diligence report, during the period between the receipt of the funding application and the final disbursement of funds, i.e. 18/02/1997 to 13/08/1998,

Zambia Pork Products (ZAPP):

SAEDF disbursed funds of $1,050, 000 to ZAPP in July 1998. ZAPP went into receivership in 2001.

Based on review of information received it appears that monitoring was done at ZAPP. Monitoring seems to have only been done during February to November 2000, but fund were disbursed during July 1998. A lengthy period of time elapsed during which there appears to be no effective monitoring and corrective action taken, and this may have resulted in loss of investment.

TV Africa:

At the SAEDF Directors meeting held on 25-26 September 2000 the problem situations in the investment portfolio were discussed. The first problem investment discussed was TVA and the comments made included the following:

- "... The company is experiencing capitalization problems as a result of low performance."
- "Apparently, the company has also been hurt by the departure of New Africa Advisor ("NAA") CEO and the forensic audit of the company currently under way."
- "Mr Lindsay stated that the Coca-Cola Company has found the company unable to deliver repeatedly."

Despite these points and the issues identified during the performance appraisal performed in August 1999, SAEDF disbursed an additional $1,718,238 to TVA during 2001.

Pick-a-Spaza (PASH):

SAEDF disbursed $1,023,109 to PASH during June 1998 and had to write off amount as promoter of the deal (Mr Pottas) used SAEDF funds for other purposes. There is no evidence on file to suggest that SAEDF tried to recover the funds.

Mozambique Equity Fund (MEF):

SAEDF invested $882,000 in MEF. No quarterly reports were on file for the period January 2003 onwards, and there is no other evidence of monitoring after this date.

The December 2002 report indicated that the fund (MEF) had only made one investment of $180,000 up to that date. This means that from the date that SAEDF disbursed the funds of $882,000 on September 28, 2001, up to December 31, 2002, SAEDF's funds were earning interest to the advantage of MEF and not yielding any returns for SAEDF. It should further be noted that the $180,000 investment by MEF was also funded proportionately by the other investors in MEF. Even though only one investment had been made by MEF's management company, the latter still received monthly management fees, which were funded from the disbursements made to MEF by SAEDF. The effect of this is that the initial funds disbursed by the various investors were being exhausted through management fees and other expenses while no other investments were made.

Cause

SAEDF had no formal monitoring and capacity building policy to ensure that the value of the investment portfolio is maintained. Investment staff neglected to monitor the operations of the investee.

Present SAEDF management could not state why disbursements of funds were still made after the investee company had ceased operations.

Effect

The poor monitoring resulted in the following questioned costs being raised:

Investee company	**Questioned cost (US$)**
Eerste River Medical Centre	$900,000
Zambian Pork Products	$ 1 050 000
TV Africa	$1,718,238
Pick-a-Spaza	$1,054,731
Mozambique Equity Fund	$882,000
Liquified Foods	$1,180,000
Total questioned raised due to poor monitoring	$6 784 969

Recommendation

- SAEDF management must develop and implement a monitoring policy to keep track of investments. The SAEDF Board and USAID must approve the policy prior to implementation.

Management comment

See investment responses.

KPMG Comment

Additional evidence was provided and finding changed were acceptable audit evidence was provided. For issues where insufficient audit evidence was provided, the findings remain.

2.14 Investment limits

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[1]

Condition

SAEDF exceeded the $1,000,000 investment limit in the following investee companies,

Investee company	Investment amount	Amount exceeding limit
Zambia Pork Products	$1,050,000	$50,000
TV Africa (TVA) / Africa Broadcasting Network	$5,000,000	$4,000,000
Pick-a-Spaza Holings	$1,054,731	$54,731
Metal Closures Group South Africa Limited	$2,159,036	$1,159,036
Megkon (Pty) Ltd / Autoster	$3,767,036	$2,767,036
Gili Greenworld	$1,916,783	$916,783
Kingdom Securities Holdings Ltd	$1,200,000	$200,000
Maxiprest	$3,771,404	$2,771,404
Kagiso Ventures Private Equity Fund	$3,184,127	$2,184,127
Liquified Foods	$1,180,000	$180,000
African Bank Corporation Holdings	$5,000,000	$4,000,000
Total questioned raised due to poor monitoring	$29,283,117	$18,283,117

[1] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Cause

- Management believed that the limits, as set out in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect

- The amounts in excess of $1,000,000 on each investment were raised are therefore questioned, i.e. in total $18,283,117

Recommendation

- SAEDF management and Board of Directors should institute control mechanisms to monitor the compliance to policies and procedures relating to investments.

Management comment

See investment responses.

KPMG Comment

No additional evidence was provided, finding remains.

Appendix 3 Summary of findings – Compliance with agreement, laws and regulations

Appendix 3

Summary of findings
Compliance with agreement,laws and regulations

February 2005

This report contains 102 pages

Report for Appendix 3

Contents

1 Detailed Findings

1.1 Timekeeping

Criteria:

According to OMB Circular A-122, Attachment B, paragraph 7(m):

a. Charges to awards for salaries and wages will be based on documented payrolls approved by responsible officials of the organisation.

b. The distribution of salaries and wages must be supported by personnel activity reports. These reports must reflect the distribution of activity of each employee. Each report must account for the total activity for which employees are compensated and which is required in fulfilment of their obligations to the organisation. The reports must be prepared at least monthly and must coincide with one or more pay periods. Also, the reports must be signed by an individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee.

According to the approved HR policies and procedures manual, paragraph 12 of the policies and procedures section:

1. SAEDF shall maintain adequate records, which reflect the payment of salaries and reasonable compensation to directors, officers and employees.

2. Any increases in salaries or other compensation shall be approved by the Board of Directors. The Board may choose to delegate to the chief executive officer the reasonability and authority for setting of salaries for employees other than the chief executive officer.

Note: After inspecting the approved SAEDF HR policies document, it is evident that an exception to the above Circular's requirement was not granted through the approved policy document.

Condition:

- For the years 1998 – 2003, there is no evidence of review and approval of the total payroll of $5,418,102. There is also no evidence that salary schedules have been signed and reviewed by an independent person prior to submission to the outside consultant for processing.
- For the years 1998 – 2003, there are no attendance registers, activity reports or timesheets kept by employees to record the time spent at work as well as tasks completed for each particular day. This situation still exists and one employee does not work at SAEDF in Johannesburg as she is based in Cape Town.

- For the years 1998 – 2003, some employees have not submitted leave forms. Thus, it is not possible to determine if the leave balances are correct since the deduction of leave balances are based on leave forms. For example, leave pay of $48,813 was paid to the employees who had resigned during the 2003 year. It is questionable whether the leave balances that were used to calculate the leave pay are correct.

Cause:

- Lack of understanding of the requirements of OMB Circular A-122 and
- Management not ensuring that staff are complying with OMB Circular A-122.

Effect:

- Salaries may be paid to employees that have not attended work and have not been performing their job functions. In view of the total non-compliance to OMB Circular A-122, salary costs of $5,418,102 for the years 1998 – 2003 as well as employee compensation benefits for medical and provident fund to the value of $769,957 for the same period have been raised as questioned costs under the point on validity of expense below.
- Unauthorised salary adjustments and payments may have been made.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Salary	$5,418,102	0	$5,418,102
Employee Compensation Benefits: Medical & Provident Fund	$769,957	0	$769,957
Employee Compensation and benefits: Life Assurance Payments	$9,314	0	$9,314
Leave Pay	$48,813	0	$48,813
Totals	**$6,246,186**	**0**	**$6,246,186**

Recommendations:

- The Contracting Officer should determine the allowability of $6,246,186 in unsupported questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comment:

Condition 1 is incorrect. The SAEDF payroll worksheets, which the auditors appear to have based their charges on, are not signed or approved. SAEDF Finance and Accounting ("Finance and Accounting") department uses Monthly Control Checklists to sign off the main monthly accounting procedures (including payroll). Once the payroll has been prepared the following are reconciled: expense accounts, salary control accounts and net payroll disbursements to the SAEDF bank statements. The Chief Financial Officer reviews and signs these reconciliations and the checklist when complete. SAEDF regards this as sufficient approval, but will implement Chief Financial Officer/Chief Executive Officer signing off the payroll runs prior to forwarding them to the service providers.

Management agrees with condition 2. However, it was decided that the same purpose would be served via the enforcement of the Human Resources Policy, especially via the use of leave forms. It is not practical to stipulate what each employee is doing for each day of the week/month/year, and if staff were not occupied with SAEDF work it would have been apparent to their manager, who would have rectified the problem. In addition the SAEDF board (including USAID) approved the SAEDF Human Resources Manual. As per OMB Circular A-122 SAEDF can use an alternative method to account for staff activity, as long as it has the approval of USAID. The approval of the HR Manual, effectively, is therefore this approval.

Condition 3 is incorrect. Staff attendance was, and still is, monitored via leave schedules. The leave days owed to staff were displayed on their monthly payslips. Staff were required to submit leave schedules with prior approval from their manager. Excessive leave days taken, contrary to labour legislation, were deducted from staff pay. However, the system was always ultimately reliant on staff honesty and there was a possibility of manipulation when staff were travelling frequently. For this reason it was possible that some staff may have taken leave without approval.

The auditor's causes are incorrect. Management is aware of the requirements of OMB Circular A-133 and feel that they have taken the necessary steps to comply.

Management feel that sufficient steps were taken to control, review and monitor timekeeping. SAEDF also took care to report any deviations from budget to the board (including USAID) via quarterly management reports. Salaries were also presented to the SAEDF board personnel committee on an annual basis for review, along with the bonus and increase recommendations.

KPMG's comment

Based on review of additional evidence it does appear that salary reconciliations between the payroll and ledger were prepared and approved up to January 2002. The actual payrolls were however not approved.

SAEDF could also not provide us with activity reports and attendance registers, the original finding thus remains.

1.2 Salary Increases - Reasonableness

Criteria:

a. According to OMB Circular A-122, Attachment B, paragraph 7, charges to awards for salaries and wages including salary increases will be based on documented payrolls approved by a responsible official of the organisation. According to the Section B, point 3.2 of the approved SAEDF HR Policy Manual, a salary range will be set for each position. Any changes in salary ranges including salary increases will be presented for the approval of the Board of Directors. The full schedule of salary ranges will be presented for Board approval no less than once each year.

b. According to Section B, point 3.3 of the approved SAEDF HR Policy Manual, the job performance of each employee will be evaluated at least twice per year, on or before the anniversary of the employee's hire date. These evaluations will consist of an appraisal conducted by the employee's immediate supervisor on whether the employee is meeting, not meeting or exceeding performance expectations detailed in the employee's job description. This performance review will serve as the basis for any appropriate merit increases in recognition of good performance.

Condition:

a. For the years 2002, there was no evidence that salary increases being approved by the Board of Directors. These amounts have been included under the questioned costs of validity of salaries.

b. For the years 1998 – 2003, there was no evidence that the percentage of salary increases given to employees is linked to performance appraisals and excessive salary increases were given to some employees for no apparent reason for example:

1. In April 2002, the CEO's Personal Assistant received an increase of 28% as she was performing the duties as Office manager and Executive Assistant. In addition to the 28%, the PA received a further 38% as at November 1, 2002. Her salary was increased to $48,000 (approximately R480 000 using an average of R10 to a dollar at the time of the increase). The Board approved the increase of 20% but there is no evidence to indicate that the Board approved the increase of 38%.

2. During April 2003, the Financial Manager obtained a salary increase from $36,000 to $55,000 (53%). A performance appraisal was done in March 2003 and the rating was above average. But, the performance appraisal that was done was not in detail, that is there were no clear defined objectives and responsibilities, and no individual rating per category was completed. The performance appraisal was not signed by the reviewer and the reviewed. Thus the performance appraisal completed does not appear to justify a 53% increase.

Cause:

- Poor management oversight or possible favouritism of staff.

Effect:

- Unauthorised or inappropriate salary increases given to employees that lead to low morale amongst other staff members.
- Question cost have been raised regarding salary costs under 1.1

Recommendations:

- SAEDF management must ensure that OMB Circular A-122 and its own Human Resources policies and procedures are complied with regard to salary increases.

Management Comment:

Condition b is incorrect. For the years 1998 to 2002 (and part of 2003) formal employee appraisals were held annually in August. The employee was appraised by his/her department head and then the department head would review the employee's appraisal with the Chief Executive Officer. If there was any disagreement between the department head and the Chief Executive Officer the increase/bonus would reflect the Chief Executive Officer's position. It is agreed that the system should not have relied so heavily on the Chief Executive Officer's opinion/attitude towards the employee/s. In recent times employee performance, and therefore appraisals, have been affected by the sequence of audits the company has undergone. For this reason the original performance targets could not be the sole evaluation item as the majority of the staff were involved in the audits.

It appears that the reasons given by the Chief Executive Officer to the SAEDF board for the increase were not accurate. The increase percentage agreed by the board did not agree with the figure given by the Chief Executive Officer and was queried by Finance and Accounting. The issue in question was communicated by SAEDF to the Audit Committee chairperson and eventually led to the investigation of the Chief Executive Officer and his eventual removal from position.

Management agrees with condition b.2. The then Chief Financial Officer forwarded an approved (by him) increase proposal to the Chief Executive Officer. The payroll was adjusted and the increase paid. However, on questioning this, and other issues, the Chief Financial Officer departed SAEDF. On review of work performance it was agreed that the increase was excessive.

Management agrees with the recommendation.

KPMG's comment

SAEDF did not provide us with any additional information regarding the reasonableness of salary increases as well as the fact that salary increases were based on formal performance appraisals, the original finding remains.

1.3 CEO Benefits

Criteria:

- Paragraph 6 of the Grant Agreement states that no employee of SAEDF may earn more than $150,000 per annum. The Grant Agreement also states that the salary limitation excludes reasonable benefits that are included in SAEDF's Personnel Compensation Policy.
- Paragraph 12 of the approved SAEDF HR policy manual states that non-South African nationals can obtain housing allowances, relocation expenses, travel allowances and similar forms of compensation provided that the compensation item is set at a reasonable level based on market circumstances and the general practices of other South African Companies.
- OMB Circular A-122, Attachment B, paragraph 7g, states that the cost of Automobiles that relates to personal use by employees (including transportation to and from work) is unallowable as a fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees.

Condition:

- There is no clear definition as to what are "reasonable benefits" in the Policy and Procedure Manual. We consider that benefits are unreasonable and unallowable for the following reasons:
  - During the years, 1998 – 2003, the CEO's had received a free use of a motor vehicle (SAEDF paid for the costs of lease payments and insurance and deducted amounts from CEO's salary), which is disallowed according to the OMB Circular A-122.
  - The CEO's were allowed to obtain Housing Allowances provided it is set at a reasonable basis. During the years 1998 – 2003, the CEO's received housing allowances (as can be seen below) which may be excessive and not set at a reasonable level based on market circumstances.
  - In addition to the above, the previous CEO also received educational benefits for his children to the value of $89,293.

The CEO's salary benefits for the years 1998 – 2003 was as follows:

Type of benefit	1998	1999	2000	2001	2002	2003
Salary	$135,000	$150,000	$150,000	$150,000	$150,000	$150,000
Housing Allowance	$48,000	$48,000	$51,000	$55,000	$36,000	$36,000
Motor Vehicle Allowance	$12,000	$14,400	$14,400	$14,400	$14,400	$24,000
Education	-	-	-	$60,926	$27,473	-
Home Leave – Usage	-	-	-	-	$9,391	-
Total	**$195,000**	**$212,400**	**$215,400**	**$280,326**	**$237,264**	**$210,000**
Percentage of CEO's allowances to Salary	44%	42%	44%	87%	58%	40%

- As can be seen above, for 2001 and 2002 the percentage of CEO's allowances to total salary was > 50%.

Cause:

- Inadequate Board oversight to ensure compliance to the Grant Agreement.

Effect:

- Excessive allowances and benefits given to the CEO that were not market related.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Employee Compensation and benefits: Housing and car allowances	$275,130	$275,130	0
Employee Compensation and benefits: Excessive employee benefits	$89,293	$89,293	0
Totals	**$364,423**	**$364,423**	**0**

Notes:

The amount of $275,130 above is comprised of housing allowances of $221,000 and motor vehicle lease payments of $54,130. The lease payments were for a vehicle that the CEO has free use of.

The amount of $89,293 above comprised educational benefits of $88,399 and a motor vehicle lease payment of $894 paid by SAEDF for a motor vehicle that was used by a previous CEO after he had left the employ of the company on 01/04/2003. This vehicle was subsequently recovered during February 2004.

Recommendation:

- The Contracting Officer should determine the allowability of $364,423 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comment:

The SAEDF board approved a US$1,200 per month motor vehicle allowance for the Chief Executive Officer. The vehicle allowance was included as income in his monthly salary and therefore was subject to FICA taxation (USA). In turn, SAEDF leased a vehicle for the Chief Executive Officer's use. The monthly lease, petrol and satellite surveillance charges were then allocated against the allowance. Initially the allowance was the US$ equivalent of the ZAR lease charge for the vehicle. However, in later years the devaluation of the ZAR resulted in the $1,200 allowance (in ZAR terms) exceeded the lease charge (in ZAR) leaving a credit balance in the expense account.

Condition 1.b is incorrect. The board approved a US$4,000 per month housing allowance for the Chief Executive Officer. At the time the ZAR equivalent (+-ZAR 18,000) was deemed reasonable for the level of residential housing approved for the Chief Executive Officer. In later years the devaluation of the ZAR increased the figure in ZAR-terms. As SAEDF is a US entity, and the Chief Executive Officer's salary paid in US$ in the United States (excl. allowances) it is irrelevant what effect the currency had on the allowance.

According to the Chief Operating Officer's contract he was entitled to US$33,000 a year to cover school costs for his children. The allowance was carried over to his term as Chief Executive Officer. It was unclear whether the year was a calendar year, SAEDF financial year or year from recruitment. The Chairman then decided, due to the urgency of the matter, to approve the additional US$13,738 (e-mail attached to bank transfer). It was decided that the costs would be averaged over the SAEDF financial years. The US$10,116 was unallowable as it related to the university costs for the Chief Executive Officer's son. This amount formed part of the SAEDF counter-claim in the lawsuit.

Management agrees with condition 2.

All of the above allowances received board approval and therefore are allowable.

KPMG's comment

SAEDF did not provide us with any additional information that indicates that the finding should change. The original finding therefore remains.

1.4 Bonuses

Criteria:

According to Section B, point 3.2 of the approved SAEDF HR policy manual, performance appraisals that should be done twice a year, serves as a basis for any appropriate merit increases including bonuses. The merit increases should not be granted to employees whose work performance is below SAEDF Standards.

OMB Circular A-122, Attachment B, paragraph 7, subparagraph (i) states, Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organisation and the employee before the services were rendered, or pursuant to an established plan followed by the organisation so consistently as to imply, in effect, an agreement to make such payment.

Condition:

- There is also no evidence that bonuses were based on performance appraisals for the period 1998-2003.

Cause:

- Bonuses were awarded at the sole discretion of the CEO (1999-2002).

Effect:

- Excessive or inappropriate bonuses may have been given to employees as there is no link between performance and bonus paid and have been raised as a questioned cost as there is no link to performance appraisals.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Employee Compensation and benefits	$389,898	0	$389,898

Recommendations:

- The Contracting Officer should determine the allowability of $389,898 in unsupported questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comment:

After conducting the appraisal process SAEDF bonus proposals are forwarded by the various department heads to the Chief Executive Officer for approval. The Chief Executive Officer, in consultation with the other department, heads agrees/disagrees with the recommended percentages/amounts. The final management authority on these amounts/percentages is the Chief Executive Officer, who then presents all SAEDF salary increases and bonuses to the SAEDF board Personnel Committee. Although the Chief Executive Officer had the final authority in the process the process was deemed acceptable by SAEDF management and board. Staff who felt that their bonuses/increases were unacceptable were free to discuss the issue with the Chief Executive Officer.

The auditor's cause is incorrect. Although the Chief Executive Officer had the final authority, his decision was influenced by the recommendations of the department heads.

Bonuses are presented to the SAEDF board Personnel Committee on an annual basis for review, along with the salary increase recommendations. The amounts were approved by the committee and are therefore allowable.

KPMG comment

SAEDF did not provide us with any additional supporting documentation indicating that formal performance appraisals were done. The original findings remain.

1.5 Lack of completion of purchase orders

Criteria:

- Paragraph 6 (accounts payable) of the SAEDF policies and procedures manual states the following in respect of purchase orders:
  - "Purchase orders for the procurement of services and supplies are raised by the various section heads"
  - "All orders are routed to the CFO for certification of availability of funds against the budget and approved by the CFO, according to his approval limit"

Condition:

During the review of the expenditure accounts the following was noted:

- No purchase orders existed for the majority (80%) of the transactions tested
- In instances where purchase orders were found, approximately 25% of the purchase orders, reviewed were not approved by any senior officials. It was thus not possible to determine if the purchase orders were valid.
- In some instances (25%) the purchase order date was after the invoice date.

Cause:

- Ignorance and/or wilful non-compliance to Paragraph 6 of the SAEDF policies and procedures.

Effect:

- As no approved purchase orders existed for most of the transactions there is no evidence that purchases made were valid.

Recommendation:

- SAEDF management must ensure that its policies and procedures relating to purchases are strictly complied with.

Management Comment:

On review of the files it appears that the relevant purchase requisitions and orders had been detached from the cheque requisition/bank transfer and filed in a separate file. Management agrees that in the 2003 financial year the use of requisitions and orders was not enforced. In addition the budget control sheets, which determine if the budget will be exceeded prior to disbursement, were not utilized at all.

It is SAEDF policy that all requisitions be approved by a senior official/head of department. However, it is possible that the auditors reviewed the purchase orders, not the purchase requisitions. On review of the Procurement Manual it is clear that the purchase requisition is the document that approves the purchase, not the purchase order. The contention that the purchases made might not have been valid is incorrect as the person who approved the invoice for payment was different from the person who prepared the order. As additional checks the Chief Financial Officer/Financial Manager approves all payments and would have noticed any unapproved expenditure.

Purchase order dates were occasionally after the invoice date due to the non-compliance with the policy by the staff preparing the purchase requisition or order. To trace the staff member who had failed to follow the procedure each department Personal Assistant was given a sequentially numbered requisition and order books. Non-adherence to the policies could be traced via the requisition/order number and the offending Personal Assistant was reprimanded. The fault in the process was that the heads of these departments failed to insist on compliance with the policies (and were sometimes the offenders) and therefore undermined the process.

The auditor's cause is incorrect (see above responses).

Management agrees with the recommendation.

KPMG comment

The files of additional evidence provided to us did not contain purchase orders or purchase requisitions. We were however shown booklet's of copies of purchase orders/requisition which seem to indicate that they were prepared in the past. We were however not provided with specific purchase order's/requisition for expenses reviewed, and thus can not say that purchase orders were always completed. Our original finding remains.

1.6 Procurement Process

Criteria:

- Paragraph 6 (accounts payable) of the SAEDF policies and procedures manual details the following approval limits:

  - Chief Executive Officer $50,000
  - Chief Financial Officer $30,000
  - Investment Officers/Directors $5,000

  - Should expenditure in excess of the predetermined limits be incurred, this is to be authorised by the Chairman of the Board and ratified at subsequent Board meetings.

  - The SAEDF policies and procedures manual also details the following with respect to the obtaining of quotations,

    - Orders less than $3,000 require one quotation.
    - Orders greater than $3,000 but less than $30,000 require three quotations.
    - Orders greater than $30,000 require approval by Contract Committee comprised of four senior managers. The composition of the committee will be periodically reviewed.

- OMB Circular A-110 section 43 and 44 on Procurement standards state that all procurement should be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interests as well as non-competitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade.

Condition:

During the review of the expenditure accounts it was noted that:

- Approval limits were not adhered to i.e. there was no evidence of approval in terms of the approval limits listed above. There were no quotations obtained for the majority (80% to 90%) of the expenses tested whereby quotations are required to be obtained.

  - There was no evidence of a tendering process being in place, On November 30, 2001 a Mckinsey invoice (No.1865) was paid for the performance of consulting work. The total amount paid for this service was $112,857. There was no evidence of a tendering process being followed, quotations obtained or approval according to the set limits i.e. no evidence of formal Chairman or Board approval.

- During January to February 2003 a second Mckinsey review was conducted on instruction of a previous CEO at a cost of $198,779. There was no evidence of any quotations being obtained and no evidence of required Chairman approval, as the expenditure exceeded $50,000. The amount of $198,779 has not yet been paid by SAEDF, but Mckinsey and company have a signed contract between SAEDF and themselves. They have since taken legal action to recover these costs and there is a possibility of them recovering this cost from SAEDF.

- During the 2002 financial year end SAEDF used Sensas Event Management (SEM) for their promotional activities. SAEDF used SEM for the following services:

    - Ambassador Andrew Young Awards Dinner ($56,329), these fees included significant amounts for technical, décor and design and professional fees.

    - Hosting a display stand at the World Summit on Sustainable Development ($9,688, this excluded the cost paid directly to the Johannesburg World Summit Company.) These fees included significant amounts for professional fees, technical, décor and design. The invoices provided by SEM did not provide any detail for SAEDF to establish the basis of these fees.

There was no evidence that a formal supplier selection process being followed i.e. quotation obtained or tender process being followed. There were also no written contracts between SAEDF and SEM. In addition, a director of SAEDF was also a director of SEM. See comment below on conflict of interest.

- During the 2002 year a consultant was awarded a contract for the SAR (Semi-Annual Review) for $40,000. A tender process was not followed in awarding this contract and no other quotes were obtained for this consulting fee. The cost of this review appeared to be excessive as in subsequent years it was completed at a much lower cost.

There was and currently is no contract committee in place.

- There was also no evidence of a tender process being done to appoint service providers (i.e. travel agents, legal services, consultants and recruitment agencies) and thus no evidence of there being competition.

- There is also no evidence of formal monitoring of service providers as there are no contracts and service level agreements with chosen service providers (travel agents, legal services, consultants and recruitment agencies)

Cause:

- Poor management review or wilful non-compliance to the SAEDF policies and procedures

- As there was no Contract Committee in place the procedures that are required by the SAEDF policies and procedures manual have not been adhered to with respect to orders greater than $30,000 obtaining Contract Committee approval.

Effect:

- As the approval limits for authorisation of expenditure detailed in the policies and procedures manual are not adhered to the possibility exists that goods and services, which are overpriced or invalid, may have been be procured.
- Unauthorised expenses may have been incurred.
- As no quotations were received and no tender process for contracts or monitoring of service providers, SAEDF may not have received the best quality of service at the most competitive price.
- As there is a signed contract between SAEDF and Mckinsey and company, SAEDF may be required to pay this amount of $198,779 and this will result in the amount being raised as a questioned cost.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Professional Services (Mckinsey and G. Cooke)	$152,857	$152,857	0
Advertising and Promotions (Ambassador Andrew Young Awards Dinner and World Summit)	$66,017	$66,017	0
Totals	**$218,874**	**$218,874**	**0**

Recommendations:

- SAEDF management must ensure that it's policies and procedures relating to procurement approval levels, the obtaining of quotations, approval, entering into contracts and service level agreement with service providers and monitoring of contracts are strictly adhered to.
- SAEDF should establish a Contract Committee.
- The Contracting Officer should determine the allowability of $218,874 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comment:

Historically quotes were obtained, according to the policy, for all purchases (excluding legal). However, the quotes were usually filed in a separate file by the Office Manager and therefore are not evident to the auditors. SAEDF will correct the system to make sure that quotes are attached to the requisition/order.

McKinsey were appointed in 2000/1 to perform the SAEDF mid-course review. As SAEDF was established in 1994/5 the mid-course review had to be performed at that time (5th year of the proposed 10 years). The approval can be found in the minutes of the executive session of the March 2000 board minutes.

In response to condition 2, management has since settled all outstanding amounts with McKinsey.

The former SAEDF Chief Executive Officer approved the expenditure in order to help promote SAEDF's image in the region. It is understood, as they involve self-promotion, that these expenses cannot be paid out of Grant funds, but can be paid from "Reflow" funds. The expense was correctly allocated to the "suspense" account in the balance sheet. This account kept track of all expenditure that did not comply with OMB requirements. In September 2002 the Finance and Accounting department incorrectly re-allocated the expense to the "promotions" account in the SAEDF income statement.

Management agrees that the tender process for the SAR consultant was not followed. SAEDF staff attempted to identify a consultant to perform the function, without any success. The Chief Executive Officer at the time knew of the consultant and approached her to provide SAEDF with a quotation. On receipt of the quotation SAEDF queried the reasonableness of the amount with the Chief Executive Officer, who confirmed that the amount was within the parameters for the required work. As Chief Executive Officer he then took the decision, as it was within his authorization limit, to approve the contract. SAEDF was satisfied with the work compiled and to management's knowledge so was USAID. SAEDF decided to replace the Contract Committee with the Office Manager. At the time the size of the organization as well as the low number of monthly vendor transactions made the Contract Committee impractical. Management at the time decided that the tasks of the committee would be better handled by the Office Manager.

The supplier selection process was not formalized and was left as the responsibility of the Office Manager. Management also instructed the Office Manager to use vendors owned by previously disadvantaged citizens (BEE). It was managements view that SAEDF's mission was also to help these companies "get off the ground" and would therefore give them a higher "weighting" in the tender process.

If any staff member was unhappy with the service offered by the vendor the Office Manager would approach them or change to another supplier. As most of the selection process was verbal, it is accepted that the process should be more formalized.

Cause 1 is incorrect (see above responses).

Management agrees with cause 2, but feel that the procedures adopted above are satisfactory and do not reduce the level of financial control.

Management agrees that policies and procedures should be adhered to.

Management believes that the idea of a contract committee is impractical for such a small organization and the task can form part of an employee's job title. Management will also update the Policies and Procedures Manual in order to reflect these changes, and to allow management to use a single supplier (without going through the tender process for each purchase) if certain steps are followed. In this way the bureaucracy will be reduced and staff can concentrate on their primary job functions.
Management feel that the procedures adopted above are satisfactory and do not reduce the level of financial control. Therefore the expenditure is allowable.

KPMG comment

SAEDF did not provide us with any additional information, the original finding remains.

1.7 Conflict of Interest

Criteria:

The Grant Agreement (Enclosure 3 [General Provisions] Section 10 [Conflicts of Interest]) states that if any directors of the grantee is a director of any other organisation, corporation or association which the grantee has entered into or considered to enter into, such director shall disclose in writing to the Board of directors all material facts as to his relationship or interest as the case may be. Such director or officer shall be recused from any participation of the Grantee with respect to such contract or transaction.

Condition:

- SAEDF used Equal Access Consulting (EAC) for all their recruiting requirements during 2002 and 2003. Through discussions with the SAEDF's staff and by reviewing internal correspondence it was evident that EAC has been used based on a Board member's recommendation. The Board member was a member of the SAEDF's Board of Directors responsible for HR matters and was a director of Adcorp Holdings Ltd. EAC was a subsidiary of Adcorp Holdings Ltd. The Board member did not disclose this interest in writing to the Board of Directors.

- SAEDF used Sensas Event Management for rendering promotional services during the 2002 year. Through discussions with SAEDF's staff, a Board decision was taken during 1999 to use black empowerment companies due to the nature of SAEDF's objectives. As a result of this decision, approximately five black empowerment companies gave presentations to SAEDF. Based on a Board member's recommendation SEM was chosen by SAEDF's staff as the firm to use for promotional activities. The Board member has been a director of Sensas Investments (Pty) Ltd (the same company as SEM i.e. SEM is registered as Sensas Investment (Pty) Ltd) since March 2000). The Board member had not formally disclosed in writing, her interest in SEM to the Board of Directors and was also responsible for recommending SEM to SAEDF.

- The Board member had an interest in Bridgestone Firestone Maxiprest. The Board member's interest was verbally announced at the meeting of the Board of directors. The announcement was minuted, but there is no written disclosure of interest being provided to the Board of Directors.

- The draft minutes of the Directors meeting of July 2002 indicated that the Board member was a Director of Ubambo Investment Holdings, which is a holding company of Ubambo Telecom's in which SAEDF committed to investment. The minutes stated that the Board member should provide full written disclosure of her interest in Ubambo. Such a written declaration as required by the Grant Agreement, could not be presented to us. This investment was however never entered into.

Cause:

- Wilful non-compliance to the requirements of the Grant Agreement or lack of knowledge of requirements of the Grant Agreement.

Effect:

- SAEDF may have paid higher than market prices for services rendered.
- There has been a contravention of the Grant Agreement, which has resulted in questioned costs being raised. The questioned costs have been raised under specific findings relating to procurement, appointment of recruitment agencies and investments.
- Similar question costs have been raised under 1.25 - appointment of recruitment agencies and 1.6 - procurement process for advertising and promotion.

Recommendation:

- SAEDF management must ensure that the Fund complies with the Grant Agreement's requirements relative to conflicts of interest with specific regard to the disclosure and recusal of directors.

Management comment:

The SAEDF board decided that as the SAEDF director in question was only a shareholder in the parent company, Adcorp Holdings Ltd, that there was no conflict of interest (SAEDF board responses to KPMG Internal Audit 2003). Management no longer uses the recruiting company and agrees that the percentages paid were high.

SAEDF has since engaged the services of one of South Africa's premier forensic investigation companies to look into these charges.

Management agrees with condition 3. The director gave full verbal disclosure of her interest in the transaction. The board instructed the Chief Executive Officer to obtain the written disclosure, which he failed to do. His services were terminated, in part, as a result of this transaction.

Management agrees with condition 4. The director gave full verbal disclosure of her interest in the transaction. The board instructed the Chief Executive Officer to obtain the written disclosure, which he failed to do. His services were terminated, in part, as a result of this transaction.

The auditor's cause is incorrect.

Management agrees with the recommendation.

KPMG's additional work performed

SAEDF did not provide us with any additional information and the finding remains.

1.8 Travel and Accommodation

Authorisation for Travel and Accommodation

Criteria:

Paragraph 10 (travel expenses) of the SAEDF policies and procedures manual details the following regarding the authorisation for travel and accommodation,

- All officers of SAEDF will complete a travel form which includes,
  - Itinerary;
  - Period of travel;
  - Hotel arrangements;
  - Flight arrangements;
  - Any other relevant details; and
  - Duration of the trip.
- Travel forms should be completed and approved before the trip is undertaken.
- Where the travel expenses, was paid for using a credit card, the credit card statements must be authorised by senior management.

Condition:

During the review of the expenditure accounts the following was noted:

- For travel undertaken by employees and officers of SAEDF, some of the trips undertaken did not have a travel form and the necessary documentation as is detailed in the policies and procedures manual. Although this condition appeared throughout all six years under review, it improved in the later years.
- In some instances travel forms were dated after the trip, or the travel form was not authorised at all.
- Travel authorization forms were sometimes approved by employees on the same staff level as the person travelling.
- Credit card statements for travel expenses, it was noted that they were not authorised by senior management.

Cause:

- Poor management review or wilful non-compliance to the SAEDF policies and procedures.

Effect:

- As travel forms detailing all the information concerning the trip were not always completed, adequate control did not exist over travel undertaken by employees. Employees may have travelled unnecessarily or for private reasons and this expense may have been borne by SAEDF.
- Adequate authorisation did not exist for travel undertaken by employees and officers of SAEDF.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Business Expenses	[1] $325,338	0	$325,338

Recommendation:

- SAEDF management must ensure that it's policies and procedures related to the detailed listing and authorisations of all travel arrangements are strictly complied with.
- The Contracting Officer should determine the allowability of $325,338 in unsupported questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comments:

Management agrees with condition 1. However it is incorrect to state that the system improved in recent years, as it appears that recently some travel authorization files have been misplaced or misfiled. SAEDF is in the process of reconstructing the files to their former state so that quick referencing to travel documentation will be possible.

In very few instances investment staff were required to travel without notice. The trip was verbally approved by the Vice President/Senior Vice President and when the Personal Assistant had the opportunity to complete the form it was done and signed. It must be mentioned that it was not possible to "hide" these trips as senior management received a detailed monthly report (Accpac-generated reports as well as the Internal Management Report) showing the trips taken during the period. Had a trip appeared in these reports that the Chief Financial Officer and Chief Executive Officer never approved the trip would have been queried during their management meetings.

It is unclear which trips an employee on the same level as the traveller approved. It is possible that one Vice President approved the travel of another Vice President. In these instances they would have done so in line with their authorisation limits.

[1] Total question costs previously reported was $365,692.

SAEDF credit card policy did not require senior investment managers to approve statements. The person who used the card signed the statement as acceptance of the itemized expenses. The senior manager would then review the statement, vouchers and charges. It is accepted that the manager should have been required to sign the statement to reflect his approval.

The auditor's cause is incorrect.

SAEDF regards their travel policies as satisfactory. However, the additions to the existing policies that SAEDF adopted informally should have been formally incorporated into the policies and procedures manual (instead of via e-mail or internal memorandum).

Management feel that the procedures adopted above are satisfactory and do not reduce the level of financial control. Therefore the expenditure is allowable.

KPMG comment

SAEDF provided us with additional supporting documentation for the question costs originally reported. As a result of the additional supporting documentation provided, the question costs have been reduced to $325,338.

However, certain documentation provided by SAEDF did not reduce the question costs, due to the documentation being inadequate. Examples include:

- No invoices and/or travel authorisation forms attached to credit card statements;
- American Express statements were provided but the amount of the expenses incurred could not be located on the statements and/or;
- No invoices were provided for some of the expenses.

1.9 Board member's expenses

Criteria:

- Paragraph 10 (travel expenses) of the SAEDF policies and procedures manual details the following regarding travel and accommodation,
  - The Board of Directors, travelling on fund business, shall be reimbursed for documented travel expenses, including transportation, lodging, meals, and related items, on the basis of actual expenses.
  - All American Express / Nedbank / Diners Club credit card holders are required to allocate the costs reflected in the statement to specific business related activities. Once the costs have been allocated the statements must be authorised by either the CEO or the CFO as is detailed in the procedures manual.
- Attachment B of OMB Circular A-122 paragraph 18 details the following regarding goods or services for personal use.
  - Costs of goods or services for personal use of the organisation's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

Condition:

During the review of the expenditure accounts the following was noted :

- Travel expenses reimbursed to Board members are not supported by receipts and invoices in all instances.
- In 75% of transactions examined there was no evidence that American Express, Nedbank and Diners Club credit card holders allocated their statement costs to specific business related activities.
- In all transactions examined American Express, Nedbank and Diners Club credit card statements were not authorised as is required by either the CEO or the CFO, and are settled by direct debit order through the Bank.

Cause:

Poor management review or wilful non-compliance to the SAEDF policies and procedures manual and Attachment B of OMB Circular A-122 paragraph 18.

Effect:

- Costs incurred by Board members could not always be verified, as there was no supporting documentation in all instances.
- As expenses incurred on American Express / Nedbank / Diners Club credit card statements were not allocated to business related activities and these statements were not authorised, expenses could have been paid for by SAEDF that did not relate to SAEDF business.

- As the American Express / Nedbank / Diners Club credit card statements allocation was not adequately performed it was difficult to agree the expenses incurred on the credit card with what was recorded in the General Ledger, this may have resulted in the misallocation of expenses.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Business Expenses	[2]$283,432	$75,566	$207,866

Recommendation:

- SAEDF management must ensure that it's policies and procedures relating to Director travel are strictly adhered to and that in terms of OMB Circular A-122 SAEDF does not pay for any personal expenditure.
- The Contracting Officer should determine the allowability of $283,432 in questioned costs ($75,566 ineligible and $207,866 unsupported) and recover from SAEDF any amounts determined to be unallowable.

Management Comments:

Vouchers for board member reimbursements were attached to all payments. In the majority of instances the auditors reviewed documents in the incorrect cashbook. In other words they reviewed documents attached to the local bank cheque number, when the payment was made via SAEDF's US-based bank.

When credit card statements arrived from Nedbank copies were made for Finance and Accounting and the originals were handed to the cardholders. The cardholder attached all vouchers to the original statement and identified all business or personal expenditure. The cardholder signed the statement verifying the correctness of the information. Finance and Accounting would then allocate the expenditure on the copy statements. Any unreturned original statements would be immediately evident. Statements were firstly reviewed by the department head, and then by Finance and Accounting. Any questionable expenditure was queried with the department head. It is agreed that department head approval was not evident and should have been enforced. The American Express card was a SAEDF "lodge" card. This meant that the card was held by SAEDF's travel agent and was used to book airfares and hotel accommodation. No approval will be evident on the Amex statement as the approval was signed via the purchase requisition, prior to purchase. In 1998, the newly created Finance and Accounting department found the Diners Club credit cards as well as SAEDF's lack of credit card policies at the time insufficient, and the cards were cancelled.

[2] Total question costs previously reported was $326,336.

New Nedbank credit cards were handed to staff after signing the newly generated credit card policy document.

The Chief Executive Officer and Chief Financial Officer were only required to check/approve the statements for staff in their own department or for one another, not for all staff. The Chief Financial Officer and department heads reviewed the statements. Management agrees that the senior manager should sign the statements as proof of review and acceptance.

SAEDF staff were not permitted to use the SAEDF credit cards for personal expenses. However, this did occur on a couple of occasions due to errors or financial predicaments. In all cases the staff members paid the amounts back to SAEDF.
The auditor's cause is incorrect (as above).

SAEDF board expenses were monitored via the monthly and quarterly management reports and presented to the SAEDF board. The costs were usually high due to the distances, and resultant airfare costs, involved in travelling to the meetings. As the board members are not paid to sit on the SAEDF board the charges do not appear excessive. In future SAEDF management will make sure the chosen hotel accommodation complies with the USAID per diem allowances.

Management feel that the procedures adopted above are satisfactory and do not reduce the level of financial control. Therefore the expenditure is allowable.

KPMG comment

SAEDF provided us with additional supporting documentation for the question costs originally reported. As a result of the additional supporting documentation provided, the total question costs have been reduced to $283,432.

However, certain documentation provided by SAEDF did not reduce the question costs, due to the documentation being inadequate. Examples include:

- Providing copies of invoices and airtickets – the originals could not be located;
- The invoice is the only supporting documentation, but it is not authorised by an independent person and/or;
- Travel and hotel invoices could not be located.

With regards to the ineligible question costs, valid documentation was provided by SAEDF for the expenses but the amounts are still ineligible. Reasons for the amount being ineligible include:

- Excessive prices for flight tickets;
- No valid reason for employees attending board meetings as well as travelling overseas to attend these meetings and/or;
- Excessive telephone costs and/or per diems given to employees being exceeded.

1.10 Officers and employees expenses

Criteria:

Paragraph 55 of OMB Circular A-122 on travel costs state:

- Travel costs are allowable when they are directly attributable to specific work or are incurred in the normal course of administration of the organisation.

- Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used results in charges consistent with those normally allowed by the organisation in its regular operations.

- Paragraph 10 (travel expenses) of the SAEDF policies and procedures manual details the following regarding travel and accommodation,

  - Officers and employees of SAEDF travelling on fund business shall be reimbursed on the basis of a per diem rate, provided that such travel is approved by the CEO or his designee. These per diem rates shall be payable upon completion of the business travel without receipts or itemisation by the officer.

  - Under no circumstances will approval be given for lodging where total cost is greater than 50% above the approved flat per diem rate for location.

  - Where the cost of the accommodation to be used is beyond the appropriate United States Government per diem rates for the location, prior written approval of the President and the CEO must be sought. Upon return from the business travel, documentary evidence for lodging in the form of receipts will need to be submitted together with the claim.

Condition:

During the review of the expenditure accounts the following was noted

- When actual expenditure was paid the per diem rate was compared to actual expenditure. In approximately 60% of the transactions reviewed the actual expenditure was excessive and there was no prior written approval from the CEO or his designee.

- Actual travel expenses reimbursed were not supported by receipts and invoices in all instances.

Cause:

- Poor management review or wilful non-compliance to the SAEDF policies and procedures.

Effect:

- Unreasonable / excessive travel expenditure may be borne by SAEDF.

- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Business Expenses	[3]$296,931	$9,468	$287,463

Recommendation:

- The Contracting Officer should determine the allowability of $296,931 in questioned costs ($9,468 ineligible and $287,463 unsupported) and recover from SAEDF any amounts determined to be unallowable.

Management Comments:

It is unclear what the auditors are charging management with. Per diems were allowed for lodging and for meals and incidentals. As accommodation was pre-booked and paid via the SAEDF credit card no lodging per diem was given. On approval of the travel form the travel request had to comply with the lodging per diem rates, and to managements knowledge did. Staff would then receive an M&IE per diem advance to cover expenses such as meals and other incidentals. Any personal expenditure was then netted off this advance when the employee submitted his claim form on his return.

All reimbursements were required to have backing documentation. On very few occasions vouchers/invoices were missing. However in these cases, the employee in question had to request copy vouchers/invoices. Failure to do so would result in the employee having to justify the expenditure (via memo) to the Chief Financial Officer and his department head. Failure to do this resulted in the questioned amounts not being refunded to the employee.

The auditor's cause is incorrect.

Some of the documentation appears to have been misplaced and is therefore impossible to verify at this stage. However, SAEDF was able to recover a large portion of the disputed amounts via the Accpac accounts payable module. SAEDF is busy reviewing the Finance and Accounting files and will not encounter these problems again.

KPMG comment

SAEDF provided us with additional supporting documentation for the question costs originally reported. As a result of the additional supporting documentation provided, the question costs have been reduced to $296,931.

However, certain documentation provided by SAEDF did not reduce the unsupported question costs, due to the documentation being inadequate. Examples include:

- Providing cheque requisition forms and/or credit card statements but no invoices could be located;

[3] Total question costs previously reported were $313,047.

- Credit card statements and invoices exists but no travel authorisation forms could be located;
- No Diners Club statements were provided and the amount on the documentation for the expense is not the same as the actual expense;
- Expense amounts could not be identified on the credit card statements;
- No supporting documentation exists for journal entries and/or;
- Travel authorisation forms are not signed by the CEO or his designee.

With regards to the ineligible question costs, valid documentation were provided by SAEDF for the expenses, but the amounts are still ineligible. Reasons for the amount being ineligible include:

- Per diem rates for employees being exceeded;
- No prior approval of actual accommodation costs being greater than the approved per diem rate and/or;
- No valid reason for executive assistant/office manager attending USAID meetings in Tanzania.

1.11 Unreasonable / excessive ineligible costs

Criteria:

- OMB Circular A-122 paragraph 3 details the following regarding Reasonableness of costs:

- A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. In determining the reasonableness of a given cost, consideration shall be given to:

  a. Whether the cost is of a type generally recognized as ordinary and necessary or the operation of the organization or the performance of the award.

  b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.

  c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.

  d. Significant deviations from the established practices of the organization, which may unjustifiably increase the award costs.'

- Attachment B of OMB Circular A-122 paragraph 18 details the following regarding Goods or services for personal use.

- Costs of goods or services for personal use of the organisation's employees are unallowable regardless of whether the cost is reported as taxable income to the employees.

Condition:

During the review of the expenditure accounts the following was noted

- In certain isolated instances there were unreasonable or prohibited expenses, e.g. purchase of alcohol, business class travel and actual expenses being greater than the per diem rate.

- For one of the Board meetings held at the Westcliff hotel, Johannesburg, the bill for accommodation included 33 "No Show" charges totalling $5,445 for bookings not taken up, which is considered wasteful. The bill also included a charge ($506) for the Personal Assistant's accommodation, which is considered unnecessary and unreasonable as she lived in the Johannesburg area and did not need the accommodation.

Cause:

- Ignorance or wilful non-compliance to OMB Circular A-122 paragraph 3.

Effect:

- Unreasonable / excessive travel expenditure borne by SAEDF.

Recommendation:

- SAEDF management must ensure that OMB Circular A-122 relating to unreasonable/excessive expenditure is strictly adhered to.
- The Contracting Officer should determine the allowability of $19,933 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comments:

The Chief Executive Officer was of the opinion that he needed his Personal Assistant to accompany him to plan the board meeting, arrange board meals, take minutes etc. It was his view that it was not unusual for a Chief Executive Officer to take an assistant on trips.

At the time the Chief Executive Officer's Personal Assistant booked board travel. It was her opinion that all senior managers should not travel on the same flight, due to the key man risk. However, it was incorrect for SAEDF to pay for the expenses while in London.

Movies were classified as personal expenditure and were therefore deducted from the M&IE allowance paid to the employee. If the expenditure in question was not deducted from the M&IE per diem then it was an error. USAID approved that SAEDF could incur expenditure on alcohol for business-related meals. The amounts were to be deducted from non-grant income.

The auditor's claim of 33 no-show rooms for the Westcliff Hotel is incorrect. In fact only 2 rooms were available of which 1 was taken by the Chief Executive Officer's Personal Assistant. This was agreed upon, as she was unhappy about travelling home alone at night.

The auditor's cause is incorrect.

KPMG comment

The 33 no-show rooms for the Westcliff relates to charges for room nights that were not used by SAEDF. This information was obtained from an invoice received from the Westcliff and confirmed with the Westcliff that charges were for unused room nights. SAEDF's comment contradicts with their previous comment under 2.2 Appendix 2 (Design of policies – Travel), where SAEDF management state no-shows were unfortunate and that organising board meetings have always been difficult.

Inspected the additional documentation provided by SAEDF for the expenses incurred. The question costs have been reduced to $19,933 from $110, 334.

1.12 Unallowable expenditure

Criteria:

- Paragraph 2 of Attachment B of OMB Circular A-122 prohibits the use of program income to purchase alcoholic beverages.
- Paragraph 11 (meals and entertainment) of the SAEDF policies and procedures manual states the following:
    - The cost of amusement, diversion, social activities, ceremonials and costs relating thereto, such as meals, lodging, rentals, transportation and gratuities are unallowable. In all cases, the costs of alcoholic beverages are unallowable.

Condition:

During the review of the expenditure accounts the following was noted regarding the use of program income:

- Purchase of alcoholic beverages to the value of $1,753.

Cause:

- Disregard for requirements of SAEDF's policies and procedures manual.

Effect:

- Non-compliance with OMB Circular A-122, paragraph 11 of SAEDF policies and procedures manual, Modification No 4 and paragraph 12 of the Grant Agreement, resulting in questioned costs to the value of $1,753 being raised.

Recommendation:

- SAEDF management must ensure that it's policies and procedures relating to paragraph 11 are strictly complied with.
- The Contracting Officer should determine the allowability of $1,753 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comments:

USAID approved that SAEDF could incur expenditure on alcohol for business-related meals. The amounts were to be deducted from non-grant income.

The auditor's cause is incorrect.

SAEDF needs to allocate all such expenditure to a separate account so that it can be deducted from non-grant income. Management will perform the reconciliation and prepare a journal entry correcting the error.
Management agrees with recommendation 2.

KPMG comment

Documentation was provided by SAEDF for the alcoholic beverages. But the question cost remains at $1,753 as there is still non-compliance with OMB Circular A-122 and the Grant Agreement.

1.13 Inadequate documentation and audit trail

Criteria:

- According to Enclosure 3, paragraph 2B, of the Grant Agreement, the Grantee shall preserve and make available such records for examination and audit by USAID and the Controller General of the United States, or their duly authorised representatives, until the Grantee is liquidated and its assets distributed and such longer period, if any, as is reasonably required to complete an audit and to resolve all questions concerning the expenditure of the US Government funds and the Grantee's compliance with the terms of the agreement.

- According to OMB Circular A-110, Subpart C, 21 (b) (7), a Recipients financial management system shall provide for accounting records including cost accounting records that are supported by source documentation.

- Paragraph 25 (Preservation of Records) of the SAEDF policies and procedures manual details the following regarding the preservation of records.

  - SAEDF shall preserve and make available such records for examination and audit by USAID and the Comptroller General of the United States, or their duly authorised representatives, until SAEDF is liquidated and its assets distributed and such longer period, if any, as is reasonable required to complete an audit and to resolve all questions concerning the expenditure of the U.S. Government funds and the SAEDF's compliance with the terms of this agreement.

Condition:

During the review of the expenditure accounts the following was noted:

- Information was incorrectly captured into the general ledger
  - For certain transactions selected the reference number relating to the relevant supporting documentation as per the General Ledger did not agree to the supporting documentation
  - Difficulty was experienced in tracing the majority of transactions that went through the accounts payable module to the supporting documentation.
- Inadequate/Lack of supporting documentation:
  - Inadequate supporting documentation to support the general ledger (Accounts Payable) entries, as all the required documentation could not be located.
  - Inadequate supporting documentation was found for approximately 80% of the transactions that related to support journal entries
  - In approximately 60% of transactions examined, no supporting documentation, in the form of invoices and till slips, were filed for credit card transactions. The only supporting documentation was the credit card statement.
  - Some expenses were misallocated to the incorrect General Ledger expense accounts.

- In some instances bank stamped paid cheques were not attached to the supporting documentation.
- The explanation on the petty cash reconciliation's, were not always adequate to determine the exact nature of the expense. The receipts were also not attached to the petty cash reconciliation and the validity of the petty cash expenses could therefore not always be verified.

- Non-compliance with Paragraph 25 (Preservation of records) of the SAEDF policies and procedures manual.

Cause:

- Poor management supervision has allowed this deficiency to remain undetected.
- Information may have been incorrectly captured from the supporting documentation to the General Ledger due to human error.
- Supporting documentation was relocated from archiving (Metro file) to the SAEDF offices; this could have resulted in the supporting documentation not been properly filed or maintained.

Effect:

- It was not possible to verify the validity of transactions selected for audit purposes, due to missing information and insufficient audit trails.
- The lack of an adequate audit trial results in documentation being incomplete.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Professional Services	[4]$485,267	0	$485,267
Employee Compensation and benefits	[5]$60,529	0	$60,529
Business Expenses	[6]$124,945	0	$124,945
Admin & other	[7]$259,643	0	$259,643
Totals	**$930,384**	**0**	**$930,384**

[4] Total question costs previously reported was $781,698.

[5] Total question costs previously reported was $84,581.

[6] Total question costs previously reported was $138,830.

[7] Total question costs previously reported was $273,821.

Recommendations:

- SAEDF must maintain records in terms of their policies and procedures.
- The Contracting Officer should determine the allowability of $930,384 in unsupported questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comments:

It is unclear what misallocations the auditor is talking about.

Condition 1.a is incorrect. All reference numbers relate to a specific document. If the reference is a "CB" it indicates that the item is a cashbook entry – usually a cheque or bank transfer reference number. If the reference is a "AP" it refers to an accounts payable entry and the reference number is a supplier invoice number. The only difference would be American Express, where invoice numbers could not be used, as SAEDF never received all backing invoices attached to the monthly statement. SAEDF had to allocate the payment directly from the Amex statement. Similarly "AR" related to accounts receivable and was a SAEDF generated invoice (usually to an investee for a debt payment). the auditors did not realise that there are a few SAEDF cashbooks/bank accounts. The general ledger reference for cashbook "04" is the Wachovia check account. SAEDF quickly found the cheque requisition, cheque and copy documentation are in the Wachovia cheque requisition file. It appears that the auditors searched the "10" cashbook files, which was the Nedbank cheque account in South Africa. On a number of occasions the auditors stated that documents were untraceable. On investigation SAEDF discovered that the reference that the auditors stated was a cheque number was in fact an invoice number. A simple trace of the invoice, via the Accpac accounts payable module, led to the original invoice and Personal payment. The auditors also mistook bank transfer reference numbers for payment references, and therefore could not trace the amount to source documents.

Condition 1.d is incorrect. Partly due to the problems mentioned above and partly due to SAEDF Finance and Accounting staff not being able to trace the references themselves. However with an understanding of the use of references (as above) and with sufficient knowledge of Accpac the transactions can easily be traced. SAEDF has all Accpac general ledger databases on the SAEDF network and the accounts payable modules for most years. By simply accessing "enquiries" and "vendor transactions" one can trace invoice numbers as well as the matching payment.

Regarding the lack of supporting documentation (condition 2):

Condition 2.a is incorrect. All of the Accpac sub-modules post into the general ledger, and then the general ledger retrieves the information. In other words all the supporting documentation for accounts payable will be attached to the payment. The only entries that are manually captured into the general ledger are journal entries. Journals are filed in separate files, with accompanying documentation. When batches are retrieved in all modules they must first be printed before they can be posted. In this way there is always a printed copy of every transaction posted to the general ledger. On review it appears that some of the Accpac printouts have been misfiled and other missing altogether. Even though these batches cannot be re-printed the information can still be viewed in the Accpac database.

The auditors did not understand the process of correcting journal entries. Essentially this was allocating an entry from one account into another. No documentation was attached to the journal as it would be attached to the original payment, and it would be pointless to copy every document. The payment and invoice are traceable through the reference number given on the journal entry (via the cashbook or accounts payable). Similarly, the auditors did not understand the workings of the suspense account. Expenses that cannot immediately be allocated to a particular account are allocated to the suspense account. Once the true nature of the expense is known the amount is reversed out of the suspense account into the correct expense account. Certain operational expenses are payable in advance. When paid the payment is allocated, via the Accpac system, to the prepayments account in the balance sheet. Journals are then passed each month releasing a portion of the payment, as per the matching principle in accounting, to the expense account in the income statement. The auditors did not understand the process and therefore could not trace the documentation/payment.

The auditors had difficulty reconciling the amounts listed on the expense claim forms (multi-currency) and the figures in the general ledger (US$). The sum total of the expense item on the hotel bill divided by the exchange rate will equal the expense claim amount. On a few occasions the auditors used the incorrect exchange rate to trace the expense to the general ledger. The rates used for expense claim and advances are shown on the face of the claim form. This policy meant that SAEDF would contra the advance against the credit shown on the claim form, thereby eliminating the need for journals to correct minor exchange differences. The missing credit card documentation was a result of misfiled credit card statements and documentation by the recent Finance and Accounting staff. Files were reconstructed without fully understanding the existing filing system resulting in documents being misplaced or misfiled.

Management agrees with condition 2.d. The allocation of expenses to the correct expense account was due to management's desire to present accurate financials. These re-allocations were usually a result of the Chief Financial Officer disagreeing with the FM on a particular allocation.

Management agrees with condition 2.e. Cheques were previously filed together with the cheque requisition. SAEDF is currently re-filing the cheques into separate files. Note: Even though the cheques were attached to the requisition a register was completed each month, and filed in the front of the cheque requisition file, indicating whether or not the cheque had been returned.

The auditors did not understand the petty cash process. All receipts/vouchers/invoices were attached to the voucher in a separate "petty cash" file. Only the reconciliation was attached to the cheque requisition. On reimbursing the petty cash the cash on hand was counted by the Financial Manager and the petty cash officer. On receipt the same 2 people counted the cash. A receipt was signed and left in the receipt book.

The auditor's causes are incorrect.

All Finance and Accounting files were retrieved from Metrofile. SAEDF will review all files at Metrofile and compile a checklist to account for future file movements.

Management agrees that it must maintain its records in terms of their policies and procedures.

SAEDF has managed to trace virtually all of the amounts that comprise the charge by understanding the processes mentioned above. The amounts are therefore allowable.

KPMG comment

SAEDF provided us with additional supporting documentation for the question costs originally reported. As a result of the additional supporting documentation provided, the total question costs have been reduced to $930,384.

However, certain documentation provided by SAEDF did not reduce the question costs, due to the documentation being inadequate. Examples include:

- Authorised memorandum provided but no invoice or travel authorisation form could be located;
- Invoices not authorised for payment;
- Faxed or copy invoices provided – no originals could be located;
- Diners club statement – no other documentation for the expense item could be located;
- No supporting documentation for journal entries;
- Providing application forms and course agendas for staff training but no invoices were attached to the documentation;
- Original supporting documentation was not provided. Only faxed or copy invoices were located.
- No invoices were attached to the credit card statements;
- No invoices were attached to bank transfer documentation; and/or
- No invoices, itinerary or travel forms attached to cheque requisitions.

1.14 Employee Termination Costs

Criteria:

- According to paragraph 2.6 of the HR Policy Manual, no employee's service may be terminated, other than in the case of voluntary resignation or contract expiry without prior consultation with the CEO. If retrenchment does occur the following must apply:

  a. All possible cost-savings measures to avoid retrenchment will be considered.

  b. Redundant employees shall be informed of their position as soon as possible.

  c. Retrenched employees will be paid out according to salary and length of service.

  Also, full and proper consultations should be held prior to the decision to retrench being taken.

Condition:

- For the years 1998 – 2003, there was no evidence that full and proper consultations were held prior to the decision to terminate the employees.

- For the years 1998 – 2002, there was no evidence of what termination costs were paid to employees that were terminated, as there was no separate account for termination costs. Management could thus not inform us of the amount of termination packages that were paid to employees, as no information regarding dismissals and termination packages were available. Amounts were also spent on legal fees.

- For the 2003-year we identified $147,554 paid as a lump sum for four employees that were asked to resign. We could not obtain any evidence of Board approval for amounts paid. An effective performance management system would not require the payment of these lump sums. We could find no supporting evidence for $4,058 in travel related to restructuring.

Cause:

- Arbitrary decisions made by various CEO's to terminate employees.

- Lack of understanding of the HR Policy Manual.

- Lack of proper controls over termination of employees.

Effect:

- Labour relation issues including court cases could arise due to unfair dismissal of employees (many in fact, did).

- Termination costs may be inaccurate and invalid and regarded as questioned costs (amount unknown).

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Restructuring Costs	$151,612	$147,554	$4,058

Recommendations:

- The Contracting Officer should determine the allowability of $151,612 in questioned costs ($147,554 ineligible and $4,058 unsupported) and recover from SAEDF any amounts determined to be unallowable.

Management Comment:

Management agrees with condition 1. Historically staff terminations have been on the instruction of the Chief Executive Officer, without adequate consultation with the SAEDF Finance and Accounting and legal departments. The primary cause was the lack of understanding of the South African labour law and therefore a lack of understanding of the steps necessary to affect the terminations. Historically the Finance and Accounting department were informed of the termination decisions after-the-fact and were informed of the month's salary to pay on termination.

Condition 2 is incorrect. All terminations prior to 2003 had detailed workings of the termination amounts and were kept in the payroll files as well as in the Financial Manager's database. The costs were allocated to the salaries expense account as the amounts were paid via the payroll system, after deduction of taxes.

The SAEDF board appointed a temporary Chief Executive Officer to administer the Fund. The Interim Chief Executive Officer was given the authority to determine the staffing requirements of the Fund. He therefore decided that the SAEDF investment department needed restructuring and therefore effected the terminations.

Management agrees with the auditor's causes.

Management agrees with the recommendation.

KPMG comment

SAEDF did not provide us with any additional supporting documentation. The question costs have therefore not been reduced. The question costs of $151,612 still remains.

1.15 Annual Financial Statements

Criteria:

- According to Enclosure 3 section F paragraph 9a of the Grant Agreement details the following regarding issue of the Annual financial statements.

  - Audited Annual Financial Statements of SAEDF must be issued by January 31 of the following year.

Condition:

The Annual Financial Report for 2002 has not yet been issued due to the current developments and is still in a final draft form;

The Annual Financial Report for 2003 has not yet been prepared and there is no visible presence of external auditors performing the external review for this period end; and

From a review of the Annual Financial Statements, the following was noted:

Annual Financial Reports	Date Issued	Issued before January 31
Annual Report 2003	Audit not commenced	No
Annual Report 2002	Not issued	No
Annual Report 2001	11 February 2002	No
Annual Report 2000	8 March 2001	No
Annual Report 1999	27 March 2000	No
Annual Report 1998	14 December 1998	Yes
Annual Report 1997	19 January 1998	Yes

Cause:

- Poor management or neglect to comply with the Grant Agreement.

Effect:

- Management, USAID and other users of information are denied timely access to management information needed for their oversight and stewardship responsibilities.

Recommendation:

- SAEDF management must ensure that the Annual Financial Report is issued by January 31 each year as required by Annexure B section F paragraph 9a of the Grant Agreement.

Management comment:

Management agrees with condition 1 and 2. The 2002 and 2003 annual external audits were stopped as a result of the US Regional Inspector General disqualifying SAEDF's external auditor from the list of USAID-approved auditors.

SAEDF management always finished the annual financials before the due date. For most years the delays in finalizing the annual financial statements were due to the following:

-Disagreement on the investment valuations,

-Finalisation of the audit report to management,

Approval from the US branch of the external auditor with respect to compliance with US GAAP.

Management agrees and will attempt to finalise the AFS prior to January 31, but as the process has been delayed by the auditors /USIG audit it will take a while to complete.

KPMG Comment

No additional evidence provided, finding remains

1.16 Performance Management

Criteria:

- According to Section B, point 3.3 of the approved SAEDF HR Policy Manual, performance appraisals should be done twice a year and serve as a basis for any appropriate merit increases including salary increases. The merit increases should not be granted to employees whose work performance is below SAEDF Standards.

Condition:

- We inspected the performance appraisals in the employee files. For some employees, performance appraisals were not being performed twice a year as can be seen below:

Details	1998	1999	2000	2001	2002	2003
Number of employees on the payroll during the year	32	31	26	35	26	9
Number of employees that did not have performance appraisals	25	15	14	22	18	4
Percentage of employees that did not have performance appraisals	78 %	48 %	54 %	63%	69%	44 %

- For the performance appraisals that were completed during the years 1998 – 2003, the following was evident:

  a. Certain performance appraisals were not signed by the appraiser and the person being appraised.

  b. Most performance appraisals were not detailed enough: there were no clear objectives, responsibilities or areas for improvement. No individual ratings were also given to the employees for the different categories to obtain the final rating.

  c. There was no set format for the performance appraisals. The appraisals that were completed were in different formats.

Cause:

- Poor performance management and lack of proper procedures and guidelines for the preparation and completion of performance appraisals.

Effect:

- The absence of a documented performance appraisal system makes it difficult for management to justify salary increases.

- Staff morale may suffer if only a few employees obtain salary increases, and the procedure is not consistent and transparent.

- Inability to review the staff on a regular basis may impact on the organisation's performance

- Questions costs were raised under timekeeping.

Recommendations:

- SAEDF must comply with its performance management policies.

Management Comments:

Appraisals were performed during these years and were signed by the appraiser and the appraised. Original Finance and Accounting appraisal forms were filed in the SAEDF safe as they contained confidential information. At no time during the auditors audit were SAEDF staff requested to provide these appraisals. SAEDF staff were appraised on performance for the past 6 months.

The appraiser would identify areas that required improvement and communicate the facts to the appraised. The appraised would then be required to identify training courses that would assist in development in these areas. In the next appraisal the appraiser would again review these areas. Staff responsibilities were detailed in their job descriptions and contract of employment and it was therefore unnecessary to repeat them in the appraisal form. Individual ratings were given but the percentages and numbers differed between departments.

Management agrees with condition 1.c. The updated HR policy, currently being completed, will rectify these issues.

Management agrees with the auditor's cause.

It is agreed that the formats were not standardized in the early years. However in 2002, after the initial McKinsey report, a standardized appraisal process was adopted. Staff strengths, weaknesses, deliverables etc were all detailed in the appraisal form. The updated HR policy, currently being completed, will rectify these issues.

KPMG comment

SAEDF did not provide us with any additional information, the original finding thus remains.

1.17 Authorisation of expenditure

Criteria:

- Paragraph 6 (accounts payable) of the SAEDF policies and procedures manual states the following:
  - Invoices must be reviewed by a person independent of the person who requisitioned the purchase.
  - For expenses to be paid a cheque requisition must be completed and the approved purchase order and original invoice must be attached to the cheque requisition.
  - Once an invoice has been paid the package of documents containing the cheque requisition, purchase order and original invoice should be stamped "paid" to avoid duplicate payment.

- Paragraph 10 (travel expenses) of the SAEDF policies and procedures manual states the following:
  - All American Express / Nedbank / Diners Club credit card holders are required to allocate the costs reflected in the statement to specific business related activities. Once the costs have been allocated the statements must be authorised by either the CEO or the CFO.

- According to sound business practices and VAT legislation expenses should only be paid on original documentation, i.e. invoices.

Condition:

During the review of the expenditure accounts the following was noted:

- Invoices were not reviewed by a person independent of the person requisitioning the purchase. It was not clear who had requisitioned the purchase, as there were no purchase orders.

- For approximately 90% of documentation examined, including the expense claims forms, the original invoice, the supporting documentation and the cheque requisition was not stamped "paid" to prevent it being resubmitted for payment.

- There were instances where expenses were paid on copies of invoices.

- There was no evidence that credit card statements were authorised in any of the transactions examined. Credit card balances were paid directly through debit order.

- Of the transactions examined 75% of the credit card statements reviewed did not contain an allocation of expenses to specific business related activities.

Cause:

- Poor management review, or wilful non-compliance to the SAEDF policies and procedures.

Effect:

- This impacted on segregation of duties and may have resulted in goods and services procured being used for non-Fund purposes.
- As the package of documents is not stamped "paid", this may have resulted in duplicate payments being made.
- Payment of expenses on copies of invoices may have resulted in duplicate payments and invalidate VAT claims.
- As credit card statements were not authorised, payments may have been made for invalid expenses.
- As credit card expenses were not allocated to specific business related activities, specific expense accounts could be misstated resulting in an inaccurate analysis of SAEDF's expenditure.

Recommendations:

- SAEDF management must ensure that it's policies and procedures relating to the authorisation and payment of all expenses are strictly complied with.

Management Comments:

The reason for an independent person reviewing the invoice was to prevent the possibility of fraud. However, with the introduction of the Procurement Manual this risk was eliminated as the originator approved the purchase requisition, the Chief Financial Officer/Financial Manager approved the purchase order and then the originator approved the invoice. It was SAEDF's view that as the originator was responsible for his own budget he should also be required to approve the invoice. By approving the invoice the originator checked the goods/service and his approval was acceptance that the goods/service was acceptable.

Accpac accounts payable module has a feature that prohibits the capturing of an invoice more than once. In addition, SAEDF policy was to only pay original invoices. In the event that an original invoice could not be found and SAEDFs accounts payable reconciliation confirmed that the invoice was outstanding then the payment was made. It is understandable that copy documentation was attached to expense claims as all originals were attached to the credit card statements (where payment was made by SAEDF credit card). Again, this is an example of the auditors misunderstanding of the processes involved. For travel reimbursements SAEDF used a spreadsheet that monitored the expenses for each business trip as well as the reimbursements. In later years it does, however, appear that this spreadsheet was not utilised and the possibility for reimbursing an employee more than once could occur. In future SAEDF will stamp the documentation "paid" to avoid duplication.

Credit card policy was that documentation was attached to the original credit card statements (Finance and Accounting allocated the copy statement for capture into Accpac). The original statement was then signed by the cardholder and reviewed by the department head. The missing credit card documentation was a result of misfiled credit card statements and documentation by the recent Finance and Accounting staff. Files were reconstructed without fully understanding the existing filing system, resulting in documents being misplaced or misfiled.

The auditor's cause is incorrect. However management does agree that the procedure needs to be reviewed and updated.

Management agrees with the recommendation. In addition management feel that the procurement process controls need to be enforced and updated.

KPMG comment

SAEDF policy manual has not been changed to indicate that invoices do no need to be approved by an independent person and thus this condition is still applicable. We could also not find evidence in most cases that purchase orders were completed for specific expenses.

1.18 Bank Reconciliation's: Prior to 1997

Criteria:

According to section 5.3 of the SAEDF's Accounting manual, reconciliations between the cashbook and the bank accounts should be performed periodically but not less then once a month. The reconciliation's will be subject to regular review by the CFO and periodical review by the CEO.

Condition:

a. No general ledgers or cashbooks were found for periods prior to 1997.

b. The boxes with bank reconciliations for this period, were scrutinised and the following was identified:

- Not all the bank reconciliation's for the period prior to 1997 were available
- None of the bank reconciliations performed during this period were reviewed by either the CFO, CEO or Financial Manager, i.e. the reconciliations were not signed as evidence of review
- The Nedbank Cheque Account reconciliations for 1996 and 1997 had a long list of reconciling items, but the dates from which these items have been outstanding, was not indicated on the reconciliation. It could thus not be determined for how long the items have been outstanding.

Cause:

a. The general ledger and cashbooks for period prior to 1997 had been lost due to poor record keeping and information on the system had not been adequately backed up due to a lack of formal disaster recovery process.

b. Bank reconciliation's for certain periods have not been done or may have been misplaced. Poor management oversight is the cause of a lack of review of bank reconciliations.

Effect:

a. Non-compliance with SAEDF's accounting manual and the accuracy and validity of information for period prior to 1997 cannot be verified.

b. The integrity of bank reconciliations for this period is in question and the possibility of irregularities cannot be ruled out.

c. Uncertainties as to the completeness of program income.

Recommendation:

- SAEDF management must ensure that it's policies and procedures relating to the bank reconciliations are strictly complied with.

Management Comment:

The SAEDF accounting system was maintained by an accounting firm prior to Oct 1, 1997. A Chief Financial Officer was appointed near the end of this period, but left SAEDF. In January 1998 a new Chief Financial Officer was appointed and then in March 1998 the Financial Manager and Accountant were appointed. Reconciliations and records comprised 1 cardboard box and were hopelessly inadequate. From March 1998 the full time department had to reconstruct the department, reports, reconciliations, etc. It was for the same reasons mentioned by the auditors that prompted SAEDF management and board to appoint the full time department. Bank recons could not be located. If located they would not have been approved by a Financial Manager or Accountant as none of these positions existed.

Management agrees with the auditor's causes.

Management agrees with the recommendation. Since the introduction of a full-time Finance and Accounting department the processes did improve. For the period prior to this, it is agreed that most documents are missing and it is difficult to determine if bank recons were completed. Management will strive to continuously improve controls in this area.

KPMG Comment

No additional evidence was provided, finding remains.

1.19 Bank Reconciliation's: 1998 - 2003

Criteria:

According to section 5.3 of SAEDF's Accounting manual, reconciliations between the cashbook and the bank accounts should be performed periodically but not less then once a month. The reconciliation's will be subject to regular review by the CFO and periodical review by the CEO.

Condition:

For the years, 1998 – 2003, no authorised bank reconciliations were available for some month's bank accounts, as follows:

- For the years 1998, 1999, 2000 and 2003, certain bank reconciliations were not reviewed by the Financial Manager or CFO.
- The reconciliation's were also not periodically reviewed by the CEO.

Cause:

- Bank reconciliation's for certain periods either have not been done or may have been misplaced.
- Poor management oversight is the cause of a lack of review of bank reconciliation's.

Effect:

- Non-compliance with SAEDF's accounting manual and the accuracy and validity of missing reconciliations cannot be verified.

Recommendation:

- SAEDF management must ensure that it's policies and procedures relating to the bank reconciliations are strictly complied with.

Management comment:

Bank reconciliations were performed monthly. The reconciliations were performed by the Accountant and reviewed by the Financial Manager. Periodically the Chief Financial Officer used to randomly sample/review the reconciliations. At month-end a "Bank reconciliation" checklist detailing all the bank account was initialled by the Accountant. The Financial Manager would then review the bank recons and sign the "Monthly Control Checklist". The Chief Financial Officer reviewed the checklist every month, and copies of the signed checklists were attached to the monthly Management as well as quarterly Treasurer's reports for review by the rest of SAEDF management (Monthly and Treasurer's reports) and the SAEDF board (Treasurer's Report only). A review of the SAEDF bank reconciliations showed that the above procedures were adhered to for a vast majority of the period in question.

The bank reconciliations were never reviewed by the Chief Executive Officer. However the Chief Financial Officer reviewed the reconciliations on a periodic basis.

Management agrees with the auditor's causes.

Management agrees with the recommendations and will strive to continuously improve controls in this area. Management, however, do not feel that it is necessary for the Chief Executive Officer and Chief Financial Officer to review bank reconciliations. Once the Chief Financial Officer is appointed he will periodically review the bank reconciliations performed by the Accountant (and primarily reviewed by the Financial Manager).

KPMG Comment

No additional evidence was provided, finding remains.

1.20 Unreasonable costs

Criteria:

- According to OMB Circular A-122: 'A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. In determining the reasonableness of a given cost, consideration shall be given to:
  - Whether the cost is of a type generally recognized as ordinary and necessary or the operation of the organization or the performance of the award.
  - The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.
  - Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.
  - Significant deviations from the established practices of the organization, which may unjustifiably increase the award costs.'

Condition:

During the review of the expenditure accounts the following was noted

Telephone costs claimed by employees:

- There were instances were telephone costs claimed during business appeared excessive.

For example:

- An employee claimed $1,372 telephone costs at The Mayflower Hotel for a 6-day business trip. The amount was on the individuals room account and there was no indication on the bill that this was business related.
- An employee claimed telephone costs of $2,173 while travelling, there was no indication on the invoice that this cost was business related.
- AT &T telephone costs of $4,989 were incurred and the only supporting documentation relation to this expense was the credit card statement. Management could not present an invoice relating to this expense.

Security costs:

- During the 2003 year, a total of $2,069 was paid for the installation of security gates at the residence of investment officers (both SA residents)

Cause:

Minimal efforts were made by management and officers of the Fund to reduce telephone costs.

Effect:

- The free spending leads to wastage of USAID funds.
- The lack of control over telephone expenditure leads to the possibility of personal expenditure paid from USAID funds.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Business Expenses	[8]$8,747	$6,574	$2,173
Admin and other	$11,812	$11,812	0
Security	$2,069	$2,069	0
Total	**$22,628**	**$20,455**	**$2,173**

Recommendations:

- The Contracting Officer should determine the allowability of $22,628 in questioned costs ($20,455 ineligible and $2,173 unsupported) and recover from SAEDF any amounts determined to be unallowable.

Management Comment:

Telephone expenses, while travelling, were charged to the hotel room and therefore to SAEDF, via the company credit card. Copies of the hotel bill were attached to the expense claim submitted on return to the office. The expenditure would therefore have been reviewed via the credit card statements, via the expense claim and finally via the detailed monthly "travel" report (included in the Management and Treasurer's Reports).

AT&T charges related to SAEDF board meeting conference calls and the Chief Executive Officer's calling card (used in the USA). As the costs were incurred while calling from the USA to South Africa it is understandable that the costs are high. However the card was utilised, as the call costs were significantly lower than calls made from hotels. It is agreed that there should have been a formalised approval process, administered by the Chief Financial Officer.

The SAEDF board approved the installation of security systems for certain SAEDF employees (see March 2000 board minutes).

The auditor's cause is incorrect. Management does not agree that the costs are excessive, but agrees that costs should be monitored to prevent abuse.

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[8] Total question costs previously reported was $9,848

Management agrees with the recommendation.

KPMG comment

SAEDF provided additional supporting documentation which reduced the total question costs to $22,628. No evidence was provided that telephone costs incurred at hotels were monitored and investigated.

1.21 Advertising and *Promotions*

Criteria:

- According to OMB Circular A-122, Attachment B, paragraph 1c, the only allowable advertising costs are those which are solely for:
  - The recruitment of personnel required for the performance by the organisation of obligations arising under a sponsored award, when considered in conjunction with all other recruitment costs.
  - The procurement of goods and services for the performance of a sponsored award.
  - The disposal of scrap or surplus materials acquired in the performance of a sponsored award.

Condition:

- During the review of the expenditure accounts the following instance was noted:

Advertising and Promotion Costs:

- Included in the promotions account was the cost of Ambassador Andrew Young's birthday party $2,500, such costs are prohibited in terms of OMB Circular A-122.

Cause:

- Ignorance or wilful non-compliance to OMB Circular A-122.

Effect:

Non-compliance with OMB Circular A-122 leading to question costs of $2,500.

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Admin and other	[9]$2,500	$2,500	0

Recommendations:

- The Contracting Officer should determine the allowability of $2,500 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

[9] Total question costs previously reported was $4,830.

Management Comments:

USAID approved that SAEDF could incur such expenditure as long as it was deducted from non-grant income. SAEDF needs to allocate all such expenditure to a separate account so that it can be deducted from non-grant income. Management will perform the reconciliation and prepare a journal entry correcting the error.

The former SAEDF Chief Executive Officer approved the expenditure in order to help promote SAEDF's image in the region. It is understood, as they involve self-promotion, that these expenses cannot be paid out of Grant funds, but can be paid from "Reflow" funds. The expense was correctly allocated to the "suspense" account in the balance sheet. This account kept track of all expenditure that did not comply with OMB requirements. In September 2002 the Finance and Accounting department incorrectly re-allocated the expense to the "promotions" account in the SAEDF income statement.

The auditor's cause is incorrect.

Management regards the expenditure as allowable for the reasons mentioned above.

KPMG comment

SAEDF provided us with additional information which reduced question costs to $2,500.

1.22 SF -272

Criteria:

- According to Enclosure 3 section F paragraph 1 (Reporting) of Grant Agreement.
  - SAEDF must submit an SF-272 "Federal Cash Transactions Report" within 15 working days following the end of each month. For the purposes of preparing SF-272, SAEDF should report the use of Federal Grant funds only and be net of any income reflows.

Condition:

For the period under review, the following period's SF-272s were not available:

- April 2003 to September 2003;
- August 2002 to September 2002.

For the period under review, not one of the SF-272s were ever completed and submitted within the 15 day limit.

Effect:

- Non-compliance to Annexure B section F paragraph 1 (Reporting) of Grant Agreement.

Cause:

- Poor management or ignorance.

Recommendations:

- SAEDF management must ensure that reporting deadlines with regard to SF-272s are complied with as required by Annexure B section F paragraph 1 (Reporting) of Grant Agreement.

Management Comment:

The SF 272's for April 2003 to September 2003 have not been completed.

The SF 272's for August 2002 and September 2002 are missing from the file.

Submission dates are communicated verbally to USAID and they were not concerned by the late submissions. The only stipulation at the time was that SAEDF would not be permitted to draw any funds down if the returns were not up to date.

The auditor's cause is incorrect. Management feel that the presentation of final/correct figures to USAID is far more important that the presentation of estimates. The delays were caused in an attempt to capture all expenses in the month they were incurred. In future the month end cut off will be moved a few days earlier so that the financials are completed earlier and therefore the SF272 and SF269 returns submitted on time.

Management agrees. SAEDF will comply with the deadline once the current audit/s are complete and the HR issues in the department have been resolved. Previously, the deadlines were missed as SAEDF wanted to present final/correct figures, instead of closing off the month and having to pass corrections in the following month.

KPMG comment

SAEDF provided us with additional evidence and the finding was adjusted accordingly.

1.23 Appointment of recruitment agencies

Criteria:

a. According to OMB Circular A-122, Attachment B, Paragraph 44:

- Costs of "help wanted" advertising and operating costs of an employment office necessary to secure and maintain an adequate staff are allowable to the extent that such costs are incurred pursuant to a well managed recruitment program.
- Where organizations uses employment agencies, costs that are not in excess of standard commercial rates for such services are allowable.

b. Paragraph 6 (accounts payable) of the SAEDF policies and procedures manual details the following with respect to the obtaining of quotations,

- Orders less than $3,000 require one quotation.
- Orders greater than $3,000 but less than $30,000 require three quotations.
- Orders greater than $30,000 require approval by Contract Committee comprised of four senior managers. The composition of the committee will be periodically reviewed.

Condition:

For the years 1998 – 2003:

a. There were no formal contracts between SAEDF and recruitment agencies. A recruitment fee of $31,496 was paid to Equal Access Consulting (EAC) for the appointment of a former CEO during 2002. A previous CEO was the Chief Operating Officer of SAEDF prior to his appointment as the CEO. There was no contract in place between SAEDF and EAC, which stated that SAEDF was responsible for this fee. It also appears that one of the agencies (EAC) did not perform qualifications verifications on the candidates that they submitted to SAEDF (see comment in Appendix 2 regarding financial manager's appointment under Appointment of employees for further details).

   The commission rate charged by the employment agencies is not agreed by SAEDF prior to appointing the employees and the percentage commission charged in certain years (2002) was higher then some of the rates charged in other years. For example, during 2000, a few recruitment agencies were used and the commission paid to the recruitment agencies varied between 16 – 19%, which is reasonable. But, in 2002, only one agency was used, Equal Access Consulting (EAC), and the rate charged by EAC was between 20 – 22%, which appears excessive. Subsequent to this issue being raised by us, EAC reduced the commission rate to 17%.

b. There is also no evidence that a tender process was followed in the appointment of recruitment agencies.

Cause:

a. Management lack of understanding of OMB Circular A-122.

b. There was and currently is no contract committee in place. (This has been highlighted under Appendix 3, note 1.6).

Effect:

a. The lack of a well-managed recruitment program, specifically during 2002 has resulted in questioned costs of $84,143 (this includes the amount of $31,496 mentioned above) and may have impacted on SAEDF's ability to recruit the best candidate for the job. Selected recruitment companies may charge excessive commission rates as compared with other recruitment companies.

b. Non-compliance with SAEDF's policies and procedures relating to the obtaining of quotations and approval by a contracting committee.

The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Employee Compensation and benefits	$84,143	$84,143	0

Recommendations:

- SAEDF should comply with existing criteria with regard to the appointment of recruiting agencies.
- The Contracting Officer should determine the allowability of $84,143 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comment:

Management agrees with condition a. Management agrees that SAEDF should not have paid the recruitment fee for the Chief Executive Officer. Management is of the opinion that the Chief Financial Officer failed in his fiduciary duties in this regard. He has since resigned from SAEDF. It is not evident why a percentage of 20% was agreed upon and management agree that the percentage was high.

Management agrees with condition b. The decision to appoint one recruitment agency was taken by the, then, Financial Manager and Chief Executive Officer. They decided that the recruitment need of SAEDF would be served best by using one company. This would build a relationship with SAEDF and thereby reduce the time for recruiting new employees.

Management agrees with the auditor causes. However, the expenditure was incurred as a result of the Chief Executive Officer and Financial Manager concluding a contract without the knowledge of the other senior managers. Although the amounts fell within the Chief Executive Officer's authority levels, it would have brought valued input into the contract and eliminated any appearance of a lack of transparency. It is therefore essential that the Chief Financial Officer enforce compliance with OMB Circular A-133.

Management agrees with the recommendations.

KPMG comment:

SAEDF did not provide us with any additional information. The original finding remains.

1.24 Training

Criteria:

- According to OMB Circular A-122, Attachment B, paragraph 53:
    - Costs of preparation and maintenance of a program of instruction including on the job, classroom, and apprenticeship training is allowable. Also, tuition and fees as well as training materials, textbooks and salaries and wages of trainees are allowable.
    - Specialized programs specifically designed to enhance the effectiveness of executives or managers or to prepare employees for such positions are allowable.
    - Costs of part-time education including that provided at the organization's own facilities, are allowable only when the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work.
- According to OMB Circular A-122, Attachment A, point 3:

  A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. In determining the reasonableness of a given cost, consideration shall be given to:

    - Whether the cost is of a type generally recognized as ordinary and necessary or the operation of the organization or the performance of the award.
    - Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.
    - Significant deviations from the established practices of the organization, which may unjustifiably increase the award costs.'

Condition:

Staff has been sent on expensive training course that may not have been appropriate or formally linked to their development needs, and may have been wasteful, for example:

During October and November 1997, 2 employees had attended a specialised Venture capital Training Course in USA. The total cost of the course was $53,698. This cost included fees, plane tickets, hotel accommodation and transport. The amounts appear to be excessive and there does not appear to be any contract binding the employees to remain in SAEDF's employ following such expensive training. They have in fact since left.

During 2003, 6 employees attended a Venture Capital Training course in Atlanta. The total cost of the course including fees and accommodation costs is $23,502. In view of the uncertainty of SAEDF's future as well as the volatility of staff at SAEDF (C. Malindi left three months after the course), the appropriateness of the decision to send staff on training courses at present is questioned.

Cause:

- There is no formal HR policy on staff training.

Effect:

- The cost of training courses attended by employees may have been excessive and may not necessarily have benefited SAEDF.
- The effect of the above on questioned costs is as follows:

Account Category	Total Questioned costs	Ineligible Questioned costs	Unsupported Questioned costs
Professional Services	$53,698	$53,698	0
Employee Compensation and benefits	$23,502	$23,502	0
Totals	**$77,200**	**$77,200**	**0**

Recommendations:

- The Contracting Officer should determine the allowability of $77,200 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management Comment:

SAEDF, at the time, could not locate any suitably qualified private equity professionals. The Chief Executive Officer recruited senior staff that had investment experience and decided to train them in the USA – hence the course. The course was an extensive senior management course and the fee was reasonable at the time. There was and still is no comparable course, in terms of quality, in South Africa. SAEDF has always adopted an employee-determined approach to training. While preparing the annual operational budget SAEDF employees decide what courses they would like to attend for the coming year and, with their department heads agreement, include them in the coming year's budget. The departmental head decides if the course will be beneficial to SAEDF and the employee or not. In addition budgeted amounts are provided for US training courses for the investment and Finance and Accounting departments. In 1998 it was SAEDF policy that employees from Financial Manager and above (Finance and Accounting) and Analyst and above Investments) qualified for overseas training once they had been with SAEDF for 2 years. It was SAEDF's view that the employee had already worked off the cost of the course and was not concerned if the employee left SAEDF soon after completing the course.

Restructuring has no relevance on the training process. In 2003 SAEDF was instructed to "carry on business as usual" during the Chief Executive Officer lawsuit and subsequent USAID audit. Had SAEDF cancelled training courses that staff were entitled to would have resulted in further staff morale and retention problems. SAEDF has always had a favourable training policy and sees the US training course as a way of rewarding and developing the employee. It must also be mentioned that the US course frequently attended is the US Venture Capital Association Conference, which relates directly to SAEDF's business.

Management agrees with the auditor's cause.

Management regards the expenditure as allowable for the reasons mentioned above.

KPMG additional work performed:

SAEDF did not provide us with ay additional information. The original finding remains.

1.25 Program Income

Criteria:

- Modification number 4 point D of the Grant Agreement states:

  'Program Income' shall be used to further program objectives and shall be subject to the same terms and conditions as funds provided under this agreement. The definition regarding Program income is:

  - Interest earned on funds
  - Other program income prior to their expenditure
  - Income earned by grantee on any activities financed by Program Income, including loan repayments, proceeds from sale of equity investments, fee income and other cash re-flows.

- According to Enclosure 3, paragraph 2B, of the Grant Agreement, the Grantee shall preserve and make available such records for examination and audit by USAID and the Controller General of the United States, or their duly authorised representatives, until the Grantee is liquidated and its assets distributed and such longer period, if any, as is reasonably required to complete an audit and to resolve all questioned concerning the expenditure of the US Government funds and the Grantee's compliance with the terms of the agreement.

Condition:

- Prior to 1998: No ledgers could be located for this period. Investments were also made from 1998, thus no significant program income for this period. There were also no reconciliations done for program income thus unable to review recording of program income.

- 1998 & 1999: Program income was kept separately in an account and reconciliations were done indicating the movement in the account.

- 2000: It appears as if program income was kept in a separate bank account, but at year-end, the balance that should have been in the account according to the reconciliation, did not correspond.

- 2001: Based upon discussions with personnel at SAEDF, it was during this year that instructions were apparently received from USAID to use program income for normal operating expenses, i.e. SAEDF was instructed by USAID to use all the current funds before any new draw downs could be made from the US Treasury. The program income lost its identity.

  Program income reconciliations were still done indicating what should be in the account. The balance per the reconciliation per the Treasurer's report did not agree to the bank account

- 2002: By scrutinising the program income bank account reconciliation as per the Treasurer's report, it is apparent that some of the income was recorded in the account, but there were various transfers made from the account to other accounts. All program income was also not transferred to the account. The reconciliation indicated what the balance in the account should have been, but this balance did not correspond with the bank balance as per the bank statements.

- 2003: No program income account reconciliation was prepared for the 2003 financial year. By scrutinising the bank statements for this period, it is apparent that operational payments were made from the account.

Cause:

- The inconsistent treatment of program income funds is due to differing understandings of the nature and permitted use of funds, as well as apparent changes in instructions as to the use of program income.

Effect:

- Program income funds received lost its identity and has been used to make operational payments, some of which may not be permitted by the Grant Agreement.

Recommendation:

- We recommend that this issue is discussed at a high level and clarified once and for all.

Management comment:

The SAEDF accounting system was maintained by an accounting firm prior to Oct 1, 1997. Reconciliations and records for the period comprised 1 cardboard box and were hopelessly inadequate. From March 1998 the full time department had to reconstruct the department, reports, recons.

Management agrees with condition 2.

Funds were transferred from the various SAEDF bank accounts into the Reflow account on a quarterly basis. If the amounts were significant transfers were done more frequently. At the time of the auditors review it is possible that the transfer had not yet been done, and the Reflow account balance was therefore lower that what it should have been.

Management agrees with condition 4. Management was told to utilize all existing (non-committed) funds for operations and investments before USAID/US Treasury would approve another grant drawdown. As bank reconciliations as well as balance sheet recons were performed every month it appears that the auditors did not refer to the correct documents. SAEDF reviewed to reconciliations and all appeared to be in order.

The 2002 financial year was as above (conditions 3 and 4). The purpose of the reconciliation mentioned was to reconcile the bank balance to the accumulated Reflow account figure.

Managements understanding was that this money would eventually be deducted from investment capital payments, which were to be returned to the Treasury, and utilized for sustainability post USAID.

Management agrees with the auditor's cause.

Management agrees with the recommendation.

KPMG additional work performed

Under condition 4 we did not say that bank reconciliations and balance sheet reconciliations were not done, we stated that the balance of the Program income account per the Treasurers report did not agree to the bank account as the Program income bank account, as this account had lost its identity during 2001. Our original finding remains.

1.26 African Bank Corporation Holdings ("ABCH")

1.26.1 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[10]

Condition:

On 27 August 2002 SAEDF made an investment of $5,000,000 in ABCH, which is in excess of the policy amount.

Cause:

Management believed that the limits, as stated in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, this increase was never submitted to USAID for formal approval.

Effect:

- The investment of $5,000,000 was not properly authorised. The amount in excess of $1,000,000, i.e. $4,000,000 is therefore questioned as an ineligible cost.

Recommendation:

- The Contracting Officer should determine the allowability of $4,000,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, subject to the provisions of the Grant

[10] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Agreement: This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The Grant Agreement does not stipulate investment authorities and contemplates that decisions regarding fall solely within the ambit of the Board and Management.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

"Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;

Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;

Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors relating to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement. The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $4,000,000 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.27 Ahanang Construction CC ("Ahanang")

1.27.1 Monitoring of investment

Criteria:

Section D.1 of Enclosure 2 to the Grant Agreement states that "The Fund's primary activity will be to provide financial resources and services through the investment of risk capital in profitable opportunities throughout Southern Africa."

Paragraph G of Modification No. 06 to the Grant Agreements further states that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

Condition:

SAEDF did not monitor the investment in Ahanang and disbursed funds ($34,120) to Ahanang subsequent to the company having ceased trading.

Furthermore, SAEDF did not secure registered bonds over the assets of Ahanang to insure itself against any losses that may be incurred.

Cause:

The condition is due to poor management oversight of the investment portfolio.

Effect:

The value of the investment portfolio was reduced by $34,120 and SAEDF lost this amount, as they did not have any security over the investment.

Recommendation:

- The Contracting Officer should determine the allowability of $34,120 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Ahanang was started in 1998 with housing construction as its core business. Initially, the business was targeting low cost housing (e,g. homes subsidized by the Reconstruction and Development Program of the government) in the impact monitoring report presented at the Semi -Annual Review in July 2002, management reported that the main support that government was to give to this business was to provide an enabling environment. The reason that Ahanang and so many similar businesses failed was because government was slow to pay. This created a cash flow problem which led to the failure of this business. See Appendix B3 for copy of impact monitoring assessment in Semi Annual Review.

The government of the Republic of South Africa changed its policy from providing funding to building contractor to directly funding the building of homes by the home owners themselves. Ahanang thus could not rely on government tenders to meet its business objectives.

This investment was extensively monitored as is evident from the monitoring documentation appended and marked "B4.

The mission of SAEDF is to provide capital under conditions of "market failure". By definition, these investments have a high level of unsystematic risk. Unsystematic risk, in this situation is defined as risk that is unique to the investment.
These high risk investments have a high exposure to event risk. The unfavorable consequences of this event risk are often interpreted as failure to monitor. Quite the contrary, investment monitoring was adequate. The event was simply unpredictable and catastrophic.

The final disbursement was made on August, 27, 2002 and the business stopped trading in August 2002. See Appendix B5 for copy of letter from investee evidencing that the business was still operating, dated August 19, 2002.

A lien was not filed at the time because there were no assets which belonged to Ahanang as the assets used by the business were subject to a Hire Purchase Agreement. A lien was not registered over the assets, because all the movable assets were subject to installment sale agreements. See Appendix B6 for the list of movable assets—leased. The total disbursement in this investment was US$ 34 120.

KPMG's additional work performed:

Reviewed the Impact Monitoring Case Study "Social Development Dividend rather than Big Financial Gain" for Ahanang Hardware and Construction prepared in April 2002.

Noted the reasons for difficulties with regard to:

The Role of the Private Sector, including SME's, in Development;

Competing Government Policies / Practices and Exogenous Factors; and

Development Venture Capital must sometimes accept Smaller returns.

Review of the Memorandum prepared by the Investment Officer, Nhlanhla Nyembe to Robert Kelley III dated March 11, 2002 noted:

The amount to be advanced on the 14th December 2001 will be used to cover operational expenses as well as working capital for the month of March 2002.

In an Ahanang Post Investment Assessment and uses of SAEDF funds dated the same day as the above memorandum, performed by the same person to Robert Kelley III it was noted:

"A total of R100,000 was transferred to a bank account belonging to a company called Baitsephi Development Consultants. Please refer to the attached documents for details on the usage of funds.

As evidenced, the funds that were to be used to cover operational expenses as well as working capital for the month of March 2002 were actually used to pay for expenses incurred in December 2001 and for which reasonable explanations and supporting documentation were not reasonably available.

It was also noted that "The main concern is that Ahanang continues to incur costs while there is no clear indication as to the commencement of the Naboomspruit project. With no revenues being generated, there is a risk of funds earmarked for the project being depleted before the project even commences."

A recommendation noted "It is recommended that Ahanag be given a dead line to commence with the Naboomspruit project. Should the company fail to meet this deadline, SAEDF should consider suspending the loan until Granny comes with a clear position regarding the project."

In an email dated 11 March 2002 from Cuthbert Malindi to Robert Kelley III reiterating the issue in Ahanang it is stated "I suggest that the money be held back until a meeting is held between Granny and yourself to state very clearly what she is allowed and not allowed to do."

Review of copies of the attached supporting documents indicates that Ahanang was paying amongst others:

R1,725 to Parks Restaurant for entertainment;

R26,676 paid to Sediba South Africa CC for community, suppliers and council meetings;

Rent, electricity and water for two properties (15 Ashford and 14 Keystone). 14 Keystone was invoiced to a DR Sid Seape;

Certain expenses were being paid that were incurred by Ahanang Agency (versus Ahanang Hardware and Construction);

Expenses were incurred that did not appear to be in the course of business (i.e. wine sets and home cutlery); and

DR S J D Seape's vodacom bill was being paid.

Ahanang is a company wholly owned by an entrepreneur – the validity of the payment for Dr Seape's personal expenses is therefore questionable.

In the September 2002 quarterly report it was noted that Ahanang has not been trading since the beginning of its financial year on March 1, 2002.

There is no evidence that a meeting was held with "Granny" to discuss these issues and funds were disbursed as follows:

14 December 2001	Funds disbursed	$28,662.85
24 January 2002	Funds disbursed	$26,839.41
18 March 2002	Funds disbursed	$16,013.34
25 April 2002	Funds disbursed	$10,034.07
3 June 2002	Funds disbursed	$8,072.55
		$89,622.22

KPMG conclusion:

Based on the review of the information and documentation subsequently provided it appears that the Ahanang investment was monitored. The monitoring however indicated that further funds should not be advanced to a dubious investee. This was either ignored or over-ridden, with no valid reasons being recorded. The $34,120 disbursed after 11 March 2002 therefore remains a questioned cost.

1.28 Babete / Maxiprest ("Maxiprest")

1.28.1 Target group

Criteria:

Paragraph E.1 of Modification No. 06 to the Grant Agreement states that the Fund will invest in enterprises that are disadvantaged by their inability to attract long-term capital investment from existing commercial sources

Condition:

- SAEDF invested $3,771,404 in Maxiprest, which is listed on the Johannesburg Stock Exchange (JSE). Enterprises listed on the JSE are large enterprises and accordingly are not considered to have difficulty attracting long-term capital investment.

Cause:

- Present SAEDF management were unable to state why the decision was taken to invest in a listed company.

Effect:

- $3,771,404 was invested in a manner that did not further the goals of the award. The investment of $3,771,404 is therefore raised as an ineligible questioned cost. On sale of the shares in Maxiprest, the actual loss to SAEDF on this investment was $170,240.

Recommendation:

- The Contracting Officer should determine the allowability of $170,240 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Maxiprest was a multi staged transaction that then Management believed required the purchase of shares in Maxiprest by SAEDF in order to be later transferred to a broad based economic empowerment group (Babete). In the long term, this target group was to assist Maxiprest in expanding its operations throughout South Africa and the region.

KPMG Comment

No additional evidence provided to amend finding – original questioned cost of $170 240 remains.

1.28.2 Performance of due diligence

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the abovementioned SAEDF Investment Policies, Guidelines and Procedures Manual requires that the due diligence process must be performed prior to approval and disbursement.

Condition:

- The due diligence for the investment in Maxiprest was conducted after the initial investment of $825,265 had already been made.

Cause:

- The condition is as a result of wilful non-adherence to the Investment Policy by the former CEO.

Effect:

- The investment in Maxiprest was made in contravention to the SAEDF investment policy and resulted in a loss of $170,240 to SAEDF and is accordingly an ineligible cost.

Recommendation:

- The Contracting Officer should determine the allowability of $170,240 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

The then CEO was disciplined by the board and eventually terminated.

KPMG comment

No additional evidence was provided, original finding remains.

1.28.3 Approval of investment

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that "the full board shall Ratify all investment decisions made by the CEO and the investment committee of the board".

Section E of Modification No. 06 to the Grant Agreement further requires that the application of the policies to individual investment decisions will be based on the business judgement of the Fund's board of directors ***and*** executive management.

Condition:

SAEDF purchased its initial shares in Maxiprest during April 2002, without any Board of Directors approval to purchase the shares.

At the Board meeting in June 2002 management requested approval to purchase Maxiprest shares. This approval was not granted.

Despite no approval being given for the Maxiprest investment, SAEDF management proceeded in acquiring further shares to the value of $2,946,138 in Maxiprest. The total investment in Maxiprest amounted to $3,771,404.

Cause:

- The condition is as a result of the CEO initially investing without Board approval, and then deliberately not adhering to the directors' decision not to acquire further shares in Maxiprest.

Effect:

- The investment in Maxiprest was made without Board approval and is accordingly an ineligible cost.

Recommendation:

- The Contracting Officer should determine the allowability of $170,240 (actual loss suffered) in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:
The then CEO was disciplined by the board and eventually terminated
KPMG comment
No additional evidence was provided, original finding remains

1.29 Eerste River Medical Centre (Cape) Ltd ("ERMC")

1.29.1 Monitoring of investment

Criteria:

Paragraph G of Modification No. 06 to the Grant Agreements states that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition:

SAEDF did not monitor the financial position of ERMC or the strategies put in place by it's promoters to achieve the forecasts given in the due diligence report, during the period between the receipt of the funding application and the final disbursement of funds, i.e. 18/02/1997 to 13/08/1998;

There were no signed audited financial statements on file for ERMC for the financial years ended 30 September 1999 and 30 September 2000 even though SAEDF had invested $900,000 in ERMC.

Furthermore, there are only three quarterly reports, prepared after disbursement of funds, on the investment file.

Cause:

- SAEDF had no formal monitoring and capacity building policy to ensure that the value of the investment portfolio is maintained. Investment staff neglected to monitor the investment once the funds had been disbursed.

Effect:

- As a result of the poor monitoring SAEDF investment staff did not identify a number of irregularities at ERMC. ERMC was liquidated and SAEDF lost the total investment ($900 000) they had made in the company.

Recommendation:

- The Contracting Officer should determine the allowability of $900,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

These high risk investments have a high exposure to event risk. The unfavorable consequences of this event risk are often interpreted as failure to monitor. Quite the contrary, investment monitoring was adequate. The event, which caused the failure of the business, was simply unpredictable and catastrophic. Please refer to appendix to for evidence of monitoring. See Appendix C1.

SAEDF acknowledges the difficulty it has had in developing small and medium enterprise business consultants. It is important to keep in mind that small business and Venture Capital is new and even today an established institutional expertise in small business does not exist. SAEDF will continue to utilize its resources to address this concern.

There are several items of correspondence between SAEDF and ERMC officers addressing specific issues in regards to the company's financials. After analyzing December 1999 unsigned financials of the company, Ms. Moyo, in a letter dated, April 10, 2000, notified ERMC of her dissatisfaction with their financials and requested that ERMC provide SAEDF with updates of the company's financial position on a monthly basis. Copies of these items of correspondence is appended hereto marked C2.

SAEDF Investment officers requested ERMC financials continuously since September 1999 and received unsigned copies on July 25, 2000. It is quite common for small businesses to compile interim financial statements without the assistance of an external auditor. The Grant Agreement as quoted in Enclosure 1, of the General Provisions, Paragraph 9, Section C, does not stipulate specifically that financial statements are to be signed.

KPMG's additional work performed:

Reviewed the following investment information subsequently provided:

Update report on Eerste River Medical Centre (Cape) Limited prepared by Mary Jean Moyo on May 20, 1998 to the SAEDF Investment Committee – discussed the current situation with regard to the revised Share Purchase Agreement. No detailed review of Eerste Rivier Medical Centre was done.;

A memorandum sent by Steven Weddle to First Growth Group summarising the background information;

Update report on Eerste River Medical Centre (Cape) Limited prepared by Mary Jean Moyo on February 1, 1999 to the SAEDF Investment Committee – discussed the delays in the construction of the hospital;

Monthly report dated December 03, 1999 – discussed the recent operating performance of the company for the 11 months to August 31, 1999;

Monthly report dated February 21, 2000 – discussed the same financial period as above with the exception that Notes to the Financial Statements were now provided and reviewed. All the variances were noted and discussed. It was noted in this report under section 4 "Cash Flows" – that the hospital was experiencing negative cash-flows impacting adversely upon the bank overdraft."

Section 5 "Adherence to applicable convenants" states that the company is in breach of the net worth covenant. The net worth as at August 31, 1999 was US$3,163,229 and the covenant stated that the net worth to be not less than US$4,500,00.

This report also noted that SAEDF was still awaiting post August 1999 financial statements.

Monthly report dated June 27, 2000 – discussed under note 3 "Loan to ERAHC". ERAHC is the outsourced casualty section of ERMC and operates independently. ERMC has a 25% equity stake in ERAHC with the balance of the shares being held by a group of doctors. During the period February 1999 to June 2000, ERMC advanced funding to ERAHC. Due to the current cash flow problem currently being experienced by ERMC, it was decided at a board meeting held on June 23, 2000 that the loan should be repaid as ERMC was not in a position to loan funds.

Monthly report dated August 25, 2000 – discussed under note B "Recent operating summary" that "the opening balances on the balances sheet have not been finalized yet by the auditors, KMMT Brey, who had been the accountants during 1999. It has also been suggested by the accountant that the current auditors be replaced with a firm of auditors that is not connected to the management or shareholding of ERMC and totally impartial.

In this report it was again noted that the company was in breach of the net worth covenant. At December 31, 1999 the net worth was US$2,632,024 versus the covenant required of US$4,500,000.

- A Monitoring Visit Report for May 2000 was performed that discussed amongst others the following:
  - The Accounting Systems and Internal Controls;
  - Pharmacy section;
  - Access to the Hospital by the use of public transport;
  - Casualty / trauma;
  - Liquidity position;
  - Breakeven position;
  - Public-private partnership proposal; and
  - Management's initiatives.

- A conference call report held on June 6, 2000 discussed the resignation of the accountant, cash flow problems and payments to directors for services rendered. A decision was taken to dispatch a SAEDF team to go to ERMC in order to extract financial information.

- A systems review was performed during the period June 19, 2000 to June 23, 2000 by a SAEDF team. A number of findings were noted and recommendations suggested by SAEDF. Some of the findings noted that the auditors KMMT Brey were also responsible for the production of accounting reports. They were also appointed as management consultants. This led to the situation where KMMT Brey produced the financial results as well as audited it.

- Monitoring Visit report in December 2000 for Fraud – This report discussed the major development that had been the discovery of fraud that had been perpetrated allegedly by the company's insurance broker against the employees' provident fund.

The Executive Summary of Findings stated:

- During the period March 1999 to August 2000, R437 377.58 had been deducted from the employees' payroll. This amount should have been invested into a provident fund run by a recognised financial institution.
- It has now been discovered that no such fund exists.
- During the period June 1999 to August 2000, R1.359.323.70 had been deducted from the ERMC bank account. The directors were under the false impression that theses amounts went towards the employees' provident fund.
- The insurance broker, Mr. Hoosen Ebrahim, has confessed to the crime. He initially implicated an ERMC director (Mr Faeez Mohamed) but subsequently withdrew this statement.

It was later noted that Mr Hoosen Ebrahim signed an agreement that the money would be repaid. Cheques to the value of R50 000 were post dated and issued by the accused which were subsequently dishonoured. There is no evidence of any further action taken against Mr Ebrahim to attempt to recover the defrauded funds.

Reviewed the letter from the Vice President (Mary-Jean Moyo) to MR Mohamed regarding the submission of financial statements. In this letter they drew to ERMC's attention that

SAEDF therefore request immediate delivery of financial information, failure by ERMC to do so will result in a breach of the Share Purchase Agreement. No further funds were issued after this. No further evidence indicates the actions taken against the investee or against the insurance broker to recover the defrauded funds.

The key issue is that there was a significant time lapse from Approval of investment (May 1997) till disbursement (August 1998) and there was no evidence of a review done on the investee. The circumstances at Eerste Rivier may have changed during this period.

KPMG Conclusion:

Based on the review of the information and documentation subsequently provided it appears that the ERMC investment was not effectively monitored, specifically from time of approval of investment to date of disbursement. There was also no evidence of corrective action taken once significant issues were identified. The original questioned costs of $ 900 000 therefore remains.

1.30 Gili Greenworld ("Gili")

1.30.1 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[11]

Condition:

SAEDF invested the following amounts in Gili:

15 February 2000	Disbursement	$	1,227,078
15 February 2000	Closing fee	$	12,286
7 August 2000	Disbursement	$	670,645
7 August 2000	Closing fee	$	6,774
		$	1,916,783

This is in excess of the policy limits.

Cause:

Management believed that the limits as stated in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect:

The investment of $1,916,783 is in contravention of the policies approved by USAID, and the amount in excess of $1,000,000 is therefore questioned.

[11] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Recommendation:

- The Contracting Officer should determine the allowability of $916,783 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comments:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, subject to the provisions of the Grant Agreement:. This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The Grant Agreement does not stipulate investment authorities and contemplates that decisions_regarding fall solely within the ambit of the Board and Management.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

"Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;

Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;

Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

Page 15 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states, "The full board shall ratify all investment decisions made by the CEO and the investment committee of the board".

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG Conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors relating to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement. The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $916,783 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.31 Kagiso Ventures Private Equity Fund ("Kagiso")

1.31.1 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[12]

Condition:

A total amount of $5 million was approved for investment in Kagiso.

SAEDF disbursed the following amounts in Kagiso for a 11,32% interest in the partnership:

12 Jan 2000	Disbursement	$	185,620
12 Jan 2000	Disbursement	$	234,466
31 Mar 2000	Re-imbursement	$	(74,410)
20 Mar 2000	Disbursement	$	558,749
26 July 2000	Disbursement	$	49,782
29 Jan 2001	Disbursement	$	43,846
23 Aug 2001	Disbursement	$	502,564
31 Jan 2002	Disbursement	$	29,750
29 Aug 2002	Disbursement	$	358,592
27 Jan 2003	Disbursement	$	33,558
8 Apr 2003	Disbursement	$	710,655
27 June 2003	Disbursement	$	506,471
5 Aug 2003	Disbursement	$	44,484
		$	3,184,127

This is in excess of the policy limits.

[12] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Cause:

Management believed that the limits, as set out in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect:

- $2,184,127 of the investment of $3,184,127 was not properly authorised, this amount is therefore questioned as ineligible.

Recommendation:

- The Contracting Officer should determine the allowability of $2,184,127 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, subject to the provisions of the Grant Agreement:. This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The Grant Agreement does not stipulate investment authorities and contemplates that decisions_regarding fall solely within the ambit of the Board and Management.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

> "Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;
>
> Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;
>
> Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG Conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors relating to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement.

The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $2,184,127 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.32 Kingdom Securities Holdings Limited ("KSHL")

1.32.1 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[13]

Condition:

SAEDF invested an amount of $1,200,000 in the purchase of preference shares in KSHL.

This is in excess of the policy limits.

Cause:

Management believed that the limits, as set out in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect:

- The investment of $1,200,000 is in contravention of the policies, as approved by USAID, and the amount in excess of $1,000,000 is therefore questioned.

Recommendation:

- The Contracting Officer should determine the allowability of $200,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, subject to the provisions of the Grant

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[13] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Agreement:. This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The Grant Agreement does not stipulate investment authorities and contemplates that decisions_regarding fall solely within the ambit of the Board and Management.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

"Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;

Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;

Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG Conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors relating to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement. The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $200,000 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.32.2 Redemption of shares

Criteria:

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extend to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

Condition:

SAEDF's Board of Directors approved an investment in KSHL. SAEDF management were under the impression that the preference shares would be redeemed in US$. During the redemption process it was, however, noticed that the Investment Agreement stated that the preference shares would be redeemed in Zimbabwean dollars (Z$) and not in US$. The Z$ was already deteriorating in value at the time of the investment.

An Internal Discussion Draft, dated February 9, 2000, prepared by Mr. Jesse J. Spikes (Long Aldridge & Norman - LAN) and addressed to a former CEO, suggests that the redemption price of the shares was incorrectly changed from US$ to Z$ during the process of drafting the agreement.

Cause:

The investment associate succumbed to pressure from KSHL and, without proper authorization, changed the agreement in order to finalise the deal.

Effect:

- SAEDF suffered a loss of US$646,308 as a result of the foreign exchange difference on redemption of the investment.

Recommendation:

- The Contracting Officer should determine the allowability of $646,308 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

In terms of the agreements with the investee, SAEDF would, on exit, redeem its preference shares at a premium. The agreements referred in every instance to the specific intended currency in terms of which certain payments would occur, these were either in US Dollars or Zimbabwean Dollars. The one instance where the agreements failed to specifically denote the preferred currency was in the provisions pertaining to the redemption of the preference shares. In this instance reference is merely made to "Dollars" without denoting which currency, which was intended.

The loss suffered in this investment is attributable to the devaluation of the Zimbawean Dollar, a situation which any investment manager could never prepare for. The direct reason for investment failure was not the lacunae in the agreement, but the failure of the Zimbabwean currency.

KPMG's additional work performed:

We have considered management's further representations, which include an admission that an error was made in the Agreement. This is the reason for the loss, not the devaluation of the Zimbabwean dollar, which was already weak at the time of the Agreement.

KPMG Conclusion:

Questioned costs of $646,308 remain valid.

1.33 Megkon (Pty) Ltd/Autoster ("Megkon")

1.33.1 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[14] (This limitation refers to initial investments only and not additional funding).

Condition:

SAEDF's initial investment in Megkon was $3,767,036, which exceeds the policy limits.

Cause:

- Management believed that the limits were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect:

- The investment of $3,767,036 was made in contravention of the Grant Agreement. The amount in excess of $1,000,000, i.e. $2,767,036 is therefore questioned as an ineligible cost.

Recommendation:

- The Contracting Officer should determine the allowability of $2,767,036 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

[14] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Management comment:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, subject to the provisions of the Grant Agreement:. This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The Grant Agreement does not stipulate investment authorities and contemplates that decisions regarding fall solely within the ambit of the Board and Management.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

"Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;

Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;

Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG Conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors relating to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement. The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $2,767,036 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.34 Mozambique Equity Fund ("MEF")

1.34.1 Monitoring of Investments

Criteria:

Section D.1 of Enclosure 2 to the Grant Agreement states that "The Fund's primary activity will be to provide financial resources and services through the investment of risk capital in profitable opportunities throughout Southern Africa."

Paragraph G of Modification No. 06 to the Grant Agreements states that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition:

SAEDF invested $882,000 in MEF. No quarterly reports were on file for the period January 2003 onwards, and there is no other evidence of monitoring after this date.

The December 2002 report indicated that the fund (MEF) had only made one investment of $180,000 up to that date. This means that from the date that SAEDF disbursed the funds of $882,000 on September 28, 2001, up to December 31, 2002, SAEDF's funds were earning interest to the advantage of MEF and not yielding any returns for SAEDF. It should further be noted that the $180,000 investment by MEF was also funded proportionately by the other investors in MEF.

Even though only one investment had been made by MEF's management company, the latter still received monthly management fees, which were funded from the disbursements made to MEF by SAEDF. The effect of this is that the initial funds disbursed by the various investors were being exhausted through management fees and other expenses while no other investments were made.

Cause:

- SAEDF did not have a formal monitoring policy. Investment staff did not adequately monitor the investment in MEF.

Effect:

- SAEDF was not alert to the impairment to its investment in MEF through the way the latter was conducting its business. Ultimately the full investment of $882,000 was written off.

Recommendation:

- The Contracting Officer should determine the allowability of $882,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

SAEDF has always conducted comprehensive monitoring of the Mozambique Equity Fund ("MEF").

SAEDF investment managers visited MEF three times in 2003 and three times during 2004. SAEDF senior investment managers have also attended board meetings on a quarterly basis.

SAEDF has co-invested in MEF along with European Investment Bank and FMO. SAEDF has been leading the restructuring process, and has, over the past twelve month, period, produced two comprehensive reports for circulation to other investor, on the state of the Fund and the proposed way forward for the Fund.

SAEDF continues to play an active role in MEF by providing capacity to the Fund where possible.

MEF has not been successful as a result of poor deal flow. SAEDF has leveraged its extensive networks and has facilitated numerous interactions between the Fund and potential promoters in Mozambique that management hopes will encourage a greater level of deal flow. Management has identified Mozambique as a difficult market in which to invest because of the regulatory framework and economic development has been very slow to date. Currently, MEF is reviewing three potential investments that were facilitated by SAEDF.

SAEDF continues to hold the investment at cost as guided by the European Venture Capital Association (EVCA) and has not written the disbursed funds off as it views MEF as an essential source of venture capital and enterprise development platform for Mozambique. See Appendix K1 for evidence of monitoring activities and K2 for SAEDF Reports on MEF.

KPMG's additional work performed:

Reviewed the Mozambique Private Equity Fund (MEF) Monitoring Report – December 2003 that noted:

"The external investment committee of GCI, which includes SAEDF, FMO and CGD, has largely been dysfunctional and unorganised. The investment committee appears to meet on an ad hoc basis; the members are slow to respond to documentation forwarded by management resulting in slow decision making. This in turn has discouraged potential promoters from directing deals to MEF."

Reviewed the SAEDF's potential exit mechanisms from MPEF prepared by Tsepo Headbush to Richard Swai and Cecil Callahan dated February 26, 2004.

Reviewed a letter "Restructuring of GCI" prepared by Cecil Callahan to the Sociedade de Capital de Risco in which they state that during an earlier monitoring visit they identified certain weak areas and their wish to conduct an assessment of GCI's operations to gain a better understanding of the operations and potential deficiencies.

Review of the Commercial Finance Services – Scope for new MEF Business prepared by Tsepo Headbush to Richard Swai and Cecil Callahan on March 29, 2004 noted that the following was discussed:

- Lack of deal flow and
- Absence of liquidity.

It also noted: "We have identified some organisational, structural and operational issues that have impeded the efficiency and effectiveness of GCI. Of primary relevance to this issue has been the effectiveness of management and the investment committee.

In the conclusion of the above report it states "It is our opinion that GCI does not have an understanding of its role in the market place, nor does not have operational capacity fulfil its perceived role. This can be attributed primarily to issues pertaining to the present structure of the organisation and other operational efficiencies. We believe that the fund lacks an understanding of its environment and this lack understanding has prevented the organisation from adapting to its surroundings. The issues outlined above define the reasons why GCI has been largely ineffective in the Mozambiquan market."

Under the recommendations they noted:

"We believe that the Investment Committee of the Fund:

- Has to be more involved and needs to provide greater guidance to the Fund;
- Should meet on a quarterly basis; possibly twice telephonically and twice in person;
- Must ensure timely decision-making and should not unnecessarily impede the investment process, thereby facilitating faster deal turn-around times.

KPMG Conclusion:

The disbursement of funds was made to the investment in 2001, the supporting documentation provided to us for review relates to December 2003 and February, March 2004. Based on the review of the supporting documentation and information subsequently provided, it appears that the investment was later monitored but even then, monitoring disclosed serious problems.

Questioned costs of $882,000 remain valid.

1.35 Metals Closure Group South Africa Limited ("MCG")

1.35.1 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF *Investment Policies, Guidelines and Procedures* Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[15]

Condition:

- SAEDF invested $2,159,036 in MCG, which is in excess of the policy limits.

Cause:

- Management believed that the limits, as stated in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect:

- The investment of $2,159,036 was not properly authorised. The amount in excess of $1,000,000, i.e. $1,159,036 is therefore questioned as an ineligible cost.

Recommendation:

- The Contracting Officer should determine the allowability of $1,159,036 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, *subject to the provisions of the Grant* Agreement:. This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The

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[15] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Grant Agreement does not stipulate investment authorities and contemplates that decisions_regarding fall solely within the ambit of the Board and Management.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

"Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;

Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;

Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG Conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors and it relates to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement. The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $1,159,036 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.36 Pick-a-Spaza Holdings ("PASH")

1.36.1 Due diligence

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the abovementioned SAEDF Investment Policies, Guidelines and Procedures Manual requires that the due diligence process must be performed prior to approval and disbursement.

Condition:

SAEDF invested $1,023,109 and $31,622 in commitment and closing fees in PASH. The due diligence performed on PASH by the SAEDF was superficial and did not address key issues.

Cause:

- Present SAEDF management are unable to state the reason for the investment associates not performing a proper due diligence or not reacting on information obtained.

Effect:

- The investment was made and SAEDF was not aware of the risk to its investment. PASH subsequently went into liquidation and SAEDF had to write off the entire investment of $1,054,731.

Recommendation:

- The Contracting Officer should determine the allowability of $1,054,731 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

An extensive due diligence was indeed performed, see appendix N1 for copy of due diligence
documents.

KPMG's additional work performed:

Reviewed the Due Diligence file and it seems that some Due Diligence was done. The Due Diligence does however not seem to be very effective i.e. Due Diligence questionnaire seems to have been completed by investee, with no evidence of being checked by SAEDF staff, no evidence of analysis of financial information and no evidence of background checks being done on promoter (i.e. Mr Pottas) of deal i.e.

KPMG Conclusion:

Based on the above it appears that the questioned costs of $ 1054 731 will remain.

1.36.2 Monitoring of Investment

Criteria:

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extend to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition:

Investigation by the investment team found that PASH had purchased shares, amounting to R2,6 million, on the Johannesburg Stock Exchange with SAEDF funds. The shares had subsequently been sold but the proceeds could not be traced back to PASH. The funds were, furthermore, used for the repayment of a shareholder's loan account (Mr. Pottas – promoter).

The full investment amount of $1,054,731 in PASH was written off. There is no evidence on file to suggest that SAEDF tried to recover the funds.

Cause:

- Present SAEDF management were not able to state why an attempt made to recover the funds.

Effect:

- As a result of poor monitoring, SAEDF found out too late that their funds had been mis-used and had to write off the entire investment in PASH after it's liquidation.

Recommendation:

- The Contracting Officer should determine the allowability of $1,054,731 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

The stock purchase transaction came to SAEDF's attention in November 1999, a month before the company stopped trading. It was specifically reported in the quarterly report that the stock purchase was made contrary to SAEDF's agreements with PASH, but there was not much SAEDF could have done about it, at that stage, as this transaction ws not disclosed to SAEDF nor was it evident from the business's financial records.

Management pursued Mr. Pottas, who in turn, signed an agreement to pay SAEDF the sum of ZAR21MM for the purchase of SAEDF's shares in PASH. He was unable to pay and promised only ZAR15MM which he could not pay after all. SAEDF approached Brink Cohen Le Roux ("BCLR") to receive an opinion as to how to collect the monies in MR. Pottas' personal capacity. BCLR advised that SAEDF should obtain Mr. Pottas' written confirmation that he was unable to pay, and if so, to institute insolvency proceedings. An investigation was done to ascertain whether Mr. Pottas had any assets which could be sold to satisfy SAEDF's claim. The claim was not pursued because no assets were found to be registered to Mr. Pottas' estate. See Appendix N4 for opinion on chances of SAEDF recovering its debt.

KPMG's conclusion:

There was an agreement between Mr Pottas and SAEDF to pay outstanding amounts, however Mr Pottas could not pay the outstanding amounts and no attempts were made to institute insolvency proceedings against him. This could lead to the perception that SAEDF is lenient with investees and does not follow up where investees do not pay SAEDF. The original finding remains and the contracting officer should determine the allowability of $1,054,731 as ineligible costs.

1.36.3 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[16]

Condition:

- An amount of $1,054,731 was invested in PASH, which exceeds the policy limits.

Cause:

- Management believed that the limits as stated in the criteria were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect:

- The investment of $1,054,731 is in contravention of the policies, as approved by USAID. The amount in excess of $1,000,000 is therefore questioned.

Recommendation:

- The Contracting Officer should determine the allowability of $54,731 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, subject to the provisions of the Grant Agreement:. This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The Grant Agreement does not stipulate investment authorities and contemplates that decisions_regarding fall solely within the ambit of the Board and Management.

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[16] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

"Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;

Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;

Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG Conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors relating to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement. The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $54,731 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.37 TV Africa ("TVA")/Africa Broadcasting Network ("ABN")

1.37.1 Due diligence

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the abovementioned SAEDF Investment Policies, Guidelines and Procedures Manual requires that the due diligence process must be performed prior to approval and disbursement.

Condition:

The investment of $5,000,000 in ABN was made in April 1999 following a due diligence that was performed by SAEDF staff. In August 1999, SAEDF invested an additional $1,718,238 in ABN.

The initial due diligence performed by SAEDF was not adequate, as it did not identify areas of concern, which were identified 4 months after disbursement. Furthermore, the SAEDF staff involved in the due diligence did not undertake sufficient research relating to the amount of capital injection that is needed for a television network.

Cause:

Present SAEDF management were unable to state why an inadequate due diligence was performed.

Effect:

- As a result of the poor due diligence, SAEDF was unaware of the inadequate capitalisation of ABN and eventually was not prepared to accede to the continuous requests for more investment funds. The full investment of $6,718,238 in ABN was ultimately written off.

Recommendation:

- The Contracting Officer should determine the allowability of $6,718,238 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Management conducted a comprehensive due diligence on TV Africa. In some areas this due diligence was more thorough than SAEDF's own due diligence questionnaire. Management evaluated all aspects of the business available during a typical due diligence review.

This included thorough review of company policies and procedures, HR, Environmental Monitoring etc. In August 1999 (4 months after disbursement), SAEDF management undertook a further appraisal of TV Africa after uncovering potential issues at TV Africa during monitoring visits. A number of these problems were only identified and occurred post SAEDF's initial due diligence review.

Once this appraisal was complete the report was forwarded to TV Africa senior management who then effectively responded and suggested an action plan to address specific ongoing concerns.
This condition actually acts as a testament to SAEDF management's thorough monitoring during this period.

Furthermore, this deal was championed by many major financial services & accounting firms such as McKinsey & Co., Solomon Smith Barney & KPMG.
Even government reform & privatization experts such as Josphat Mwaura, director of KPMG Consulting (Kenya), the same affiliated organization as the current auditors, were extremely supportive of TV Africa citing it as crucial part of infrastructural development of continental Africa in 'Ten Degree Africa.

See Appendix O1 for transaction summary detailing due diligence processes.

KPMG's additional work performed:

Reviewed the Project Summary Report for TV Africa (under Appendix O1) in which a detailed post investment report was performed. The following was discussed:

- Project description;
- Investment terms;
- Actual and projected performance;
- Valuation and pricing by Salomon Smith Barney / AIG and SAEDF;
- SAEDF Valuation and discussion of such;
- Projected returns;
- Exit;
- Background on the company;
- Company Historical Performance Overview and Future Prospects;
- The terms of SAEDF original investment and current shareholding;
- Future shareholding and return analysis with 3 scenarios;

- Market analysis;
- Competitor analysis; and
- Recommendations.

This summary reports however relates to work done when additional funding was requested and not the initial Due Diligence.

KPMG Conclusion:

Based on the review of the documentation and information subsequently provided by SAEDF, it appears that the project summary report relates to the monitoring performed once the initial funds had already been issued and the original finding therefore stands.

The Contracting Officer should determine the allowability of $6,718,238 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

1.37.2 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[17] (This limitation refers to initial investments only and not additional funding).

Condition:

- SAEDF's original investment, made on 29 April 1999, in TVA was $5,000,000, which exceeds the policy limits.

Cause:

- Management believed that the limits as stated in criteria were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on February 27, 1999. However, this increase was never formally approved by USAID.

Effect:

- The investment of $5,000,000 is in contravention of the policies, as approved by USAID. The amount in excess of $1,000,000 is therefore questioned.

Recommendation:

- The Contracting Officer should determine the allowability of $4,000,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, subject to the provisions of the Grant Agreement:.

[17] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The Grant Agreement does not stipulate investment authorities and contemplates that decisions_regarding fall solely within the ambit of the Board and Management.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

"Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;

Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;

Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG Conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors relating to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement. The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $4,000,000 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.37.3 Indigenous participation

Criteria:

Section E.2 of Enclosure 2 to the Grant Agreement states that; "The Fund will invest only in indigenous firms." "Indigenous" firms, means those with an indigenous majority ownership or a plan to achieve indigenous majority ownership.

Condition:

The only other shareholder in ABN after SAEDF's investment was New Africa Advisors ("NAA"). NAA is a wholly owned subsidiary of Sloan Financial Group, a $4 billion Durham, North Carolina financial services group. NAA and its affiliate New Africa Management specialise in providing investment advisory services to US institutional investors.

SAEDF's investment in ABN therefore resulted in 100% of the equity shareholding of ABN being held by US funded organisations.

Cause:

- Present SAEDF management were unable to state the reason for the investment in ABN.

Effect:

- The investment in ABN did not benefit an indigenous emerging enterprise and thus contravenes the requirements of the Grant Agreement. It is therefore questioned on these grounds.

Recommendation:

- The Contracting Officer should determine the allowability of $6,718,238 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

African Broadcast Networks (ABN) was the pioneer Pan African free-to-air television broadcaster. SAEDF's investment in ABN had a clear empowerment and indigenous enterprise beneficiation dimension as ABN entered into direct partnerships with a number of privately owned locally licensed television affiliates. Local Black entrepreneurs owned the majority of ABN affiliates. ABN had a direct intention to acquire significant minority stakes of between 26% and 49% in the affiliates. It was understood that ABN's investment in these local affiliates would be utilized to upgrade the broadcasting infrastructure of the local affiliates.

Through this direct investment, it was anticipated that ABN would effectively be a platform upon which local black-owned broadcasting stations would be established across the African continent.

KPMG's additional work performed:

We have considered management's further representations, which we find unconvincing.

ABN is a South African Media company incorporated in Mauritius for tax and exchange control reasons and the shareholders were not indigenous.

KPMG Conclusion:

Questioned costs of $6,718,238 remain valid.

1.38 Ubambo Telecommunications (Pty) Ltd ("Ubambo")

1.38.1 Spirit of the Grant Agreement

Criteria:

The mission of the fund listed on Page 4 of the SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 and approved by SAEDF Board and USAID includes to "promote the development of broader capital accumulation by investing in enterprises that are "historically disadvantaged" as a result of former socio-political practices".

Section A of Enclosure 2 to the Grant Agreement states the purpose of the fund "is to encourage the creation and expansion of indigenous small and medium-sized enterprises in the southern Africa region".

Condition:

SAEDF invested $59,070 in Ubambo. Ubambo's business plan was to buy-out the interest of the other black economic empowerment entities in the CellSAf shareholding in order to increase their stake in Cell C (Pty) Ltd, i.e. Ubambo was purchasing the minority shareholders rights in CellSAf to strengthen their own shareholding in Cell C (Pty) Ltd.

This transaction violates the spirit of the Grant Agreement as USAID funds were to be used to buy out minority shareholders (mainly historically disadvantaged individuals), and concentrate their stake in the hands of a few wealthy individuals.

The investment was initially approved by the SAEDF Board, but was later stopped by the Board as they realised that the transaction would be against the spirit of the Grant Agreement.

Cause:

- The cause was due to wilful contravention of the Grant Agreement by SAEDF management.

Effect:

- The amount disbursed in this investment, i.e. $59,070 is questioned as an ineligible cost due to the fact that it is in clear contravention of the spirit of the Grant Agreement.

Recommendation:

- The Contracting Officer should determine the allowability of $59,070 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

This investment is not in violation of the Grant agreement nor the OMB circular A-122. Charges based upon the spirit of the Grant Agreement, may be spurious and unfair because of the subjective nature of interpreting the spirit of the Grant Agreement.

KPMG Conclusion:

No additional evidence was provided, original finding remains. The Contracting Officer should determine the allowability of the $ 59 070 ineligible costs.

1.39 Vantaris Capital Fund ("VCF")

1.39.1 Maintenance of records

Criteria:

Section 2.A of Enclosure 3 to the Agreement states; "The Grantee shall maintain books, records, documents, and other evidence in accordance with generally accepted accounting practice. The Grantee's financial management system shall: (i) provide for accurate, current, and complete disclosure for each Grantee-sponsored activity; (ii) identify adequately the source and application of funds for all Grantee-sponsored activities, and (iii) enable the Grantee to accurately determine Grant balances, book balances and reconciliation of book to Grant balances."

Condition:

The following payments to VCF, as per the general ledger, could not be traced to the bank statements for the iAfrica Investment Account, due to the bank statements not being on file:

General ledger entry date	Amount – $
7 April 2000	$27,333
31 January 2001	$21,277
6 July 2001	$19,726
Total	**$68,336**

The approved journal voucher (9/34) and supporting calculations relating to the provision for the write-off of the investment in VCF for the amount of $9,927 was not in the journal file.

Cause:

- Present SAEDF management were unable to state the reason for the condition.

Effect:

Without the supporting documentation it is not possible to substantiate the above disbursements/provision.

The disbursed amount of $68,336 as well as the provision of $9,927 is thus questioned as ineligible costs.

Recommendation:

- The Contracting Officer should determine the allowability of $78,263 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comments:

No additional supporting documentation i.e. approved journals etc providing, questioned cost of $ 78 263 remains.

1.40 Zambia Pork Products ("ZAPP")

1.40.1 *Monitoring of Investment*

Criteria:

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition:

SAEDF disbursed funds of $1,050, 000 to ZAPP in July 1998. ZAPP went into receivership in 2001. Only 5 quarterly reports were prepared during this period. During the course of SAEDF's investment in ZAPP certain information relating to the use of SAEDF funds and poor internal controls of ZAPP were brought to the attention of SAEDF management. SAEDF, however, did not take any action.

Cause:

- Present SAEDF management were unable to state the reason for the poor initial monitoring or the lack of decisive action when breaches of the investment conditions were discovered.

Effect:

SAEDF were initially unaware of the true status of ZAPP's financial position due to the poor monitoring. When breaches of the investment conditions were discovered, management exposed SAEDF to unnecessary risk by not taking decisive action.

ZAPP was placed into receivership and the total investment in ZAPP written off resulting in the decline of SAEDF's investment portfolio value.

Recommendation:

- The Contracting Officer should determine the allowability of $1,050,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

An extensive amount of monitoring was done in this transaction. See Appendix Q1 for copies of monitoring documentation to improve SAEDF's monitoring efforts in an attempt to implement tougher control. Further, SAEDF assigned Amanda Greef to ZAPP for three months to help them set up accounting and other financial systems.

KPMG's additional work performed:

Reviewed an action plan for Zambia Pork Products Limited prepared by Steven Weddle to the CEO of NORASAD which clarified the way forward regarding their mutual investee company. This report indicated a decisive action and business plan splitting the responsibilities of SAEDF and NORASAD in an attempt to improve the situation at ZAPP.

When ZAPP had not been able to service its debt obligation to SAEDF, as part of the monitoring strategy and in an attempt to strengthen SAEDF's portfolio, the monitoring team was looking at ways to assist ZAPP to achieve profitability and sustainability. The first step was to perform a week's due diligence to ascertain the extent of the problems and weaknesses within the company. The supporting due diligence is discussed below.

Reviewed the Due Diligence report which set out to SAEDF management their findings and recommendations. This memo did not seek a further capital injection into the company as the monitoring team would like to see that their recommendations first be implemented before any further capital injection be considered. The same report went on to discuss the historical performance, project description, company profile, capital structure and economic outlook. There was however no date on this report to indicate when it was performed.

Reviewed the Board discussion points – ZAPP prepared by Nontobeko Ntsinde and Amanda Greef to Steven Weddle on November 7, 2000 which discussed the appointment of auditors, way forward regarding the financial manager and Barclays Bank's willingness to increase the bank overdraft.

Reviewed the Report – Zambia Pork Products Limited prepared by Amanda Greef to Nontobeko Ntsinde on October 4, 2000. Please refer to attached documents for further issues at ZAPP.

Reviewed the Monitoring Report – Zambia Pork Products Limited prepared by Lindiwe Toyi and Amanda Greef to Nontobeko Ntsinde on August 30, 2000. This report discusses that the monitoring team had meetings between August 21 to August 25, 2000 with the following people:

- The CEO of the company;
- The Financial Manager of the company;
- The auditors of the company;
- The CEO of NORSAD; and
- The project economist.

The various discussions held were documented and follow up was performed as evidenced by the Report – Zambia Pork Products Limited prepared by Amanda Greef to Nontobeko Ntsinde on October 4, 2000.

Reviewed the quarterly report for September 2000, dated November 10, 2000 for the fiscal year end March 31, 2000. This report discussed the recent operating summary, operating performance, variance analysis and outlooks.

The exact same work was discussed in the following quarterly reports:

- Dated August 13, 2000 for the fiscal year ended March 31, 2000;
- Dated June 23, 2000 for the fiscal year ended March 31, 2000; and
- Dated February 10, 2000 for the fiscal year ended March 31, 2000.

Reviewed the Travel Authorization Form for Amanda Greef (Investment Analyst) dated 22-02-2001 which should that she had been approved to travel to Zambia from 25/022001 to 31/03//2001 in order to monitor ZAPP and Liquefied Foods. This was only an authorization form and no documentary evidence was provided of the monitoring performed during this period.

KPMG Conclusion:

The time period between the disbursement of the funds in July 1998 and the monitoring reports provided above (February to November 2000) however indicates that the monitoring was not done timeously. A lengthy period of time elapsed during which there appears to be no effective monitoring and corrective action taken.

Questioned costs of $1,050,000 remain valid.

1.40.2 Investment limits

Criteria:

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[18]

Condition:

- SAEDF's initial investment in ZAPP amounted to $1,050,000, which is in excess of the policy limits.

Cause:

- Management believed that the limits, as stated in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, this increase was never formally approved by USAID.

Effect:

- The investment of $1,050,000 is in contravention of the policies, as approved by USAID. The amount in excess of $1,000,000 is therefore questioned.

Recommendation:

- The Contracting Officer should determine the allowability of $50,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

Section B of the Grant Agreement provides that the board of directors and executive management of the Fund, "will have maximum flexibility in the manner in which the Fund is structured and its strategic and operating decisions, subject to the provisions of the Grant Agreement:. This provision permits the board and management to freely make operational decisions provided they do not conflict with the provisions of the Grant Agreement. The Grant Agreement does not stipulate investment authorities and contemplates that decisions_regarding fall solely within the ambit of the Board and Management.

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[18] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Accordingly, on June 17, 1998, a decision was taken by the board to increase the investment limits of the investment committee and local management as follows:

Investment Policy Committee from US$1MM to US$2.5MM

Local Management: from US$50,000 to USD 1 MM.

On February 25, 1998, a decision was taken by the board to further increase the investment authority of the investment committee and local management as follows:

Investment Policy Committee from US$2.5MM to US$5MM

Local Management: from USD 1 MM to USD 2.5. See Appendix A2 and A3 for copies of the Board Minutes containing this resolution.

KPMG's additional work performed:

The originals of the Minutes of Strategy Session of the Board of Directors and On-Site Management Staff of Southern Africa Enterprise Development Fund held on June 17, 1998 were reviewed and approval was noted for the increase in investment authority, as follows:

. "Resolved, that the investment credit authority of the Investment Policy Committee for a single transaction or a company (whichever is applicable) be, and same hereby is, increased from USD 2.5 million to USD 5 million;

Resolved, that the investment credit authority of SAEDF's on-site management for a single transaction or company (whichever is applicable) be, and same hereby is, increased from USD 1 million to USD 2 million;

Resolved further, that SAEDF funds may be disbursed for investment purposes with respect to a properly approved transaction pursuant to the joint signature of either the President and the CFO or the President and any two senior vice presidents of SAEDF."

However Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer.

Section 12 of Enclosure 3 to the Grant Agreement states that the Grantee agrees that without the prior written approval of USAID, it will not make any material change in its corporate structure, Certificate of Incorporation, By-Laws, Statement of Corporate Policies and Procedures, personnel compensation policies or environmental policies that would be contrary to the terms and conditions of this Grant or applicable legislation.

The increase approved by the Board of Directors (discussed below) would constitute a significant change in Corporate Investment Policy as the increase in the authority limit would have a significant impact on the risk of the Fund and this change should therefore have been approved by USAID.

There is no evidence that the increase in the investment authority was reviewed and approved by USAID.

KPMG Conclusion:

Based upon the review of the documentation and information subsequently provided by SAEDF, the increase in Credit Approval Authority was approved by the Board of Directors and it relates to the Investment limits. However this relates to a change in policy that was not approved by USAID and should therefore not be allowed in terms of Section 12 of Enclosure 3 to the Grant Agreement. The increase in the authority limits constitutes a significant change in Corporate Investment Policy and without approval by USAID, the original finding still remains and an amount of $50,000 being the excess funds disbursed over the $1,000,000 investment limit is therefore ineligible and a questioned cost.

1.41 Ruashi Copper-Cobalt mine

1.41.1 Investment outside target area

Criteria:

Section A of Modification No. 06 to the Grant Agreement states: "Against this background, the purpose of the Southern Africa Enterprise Development Fund (the "Fund" or "Grantee") is to encourage the creation and expansion of indigenous emerging enterprises, including small and medium-sized firms, in the southern Africa region, specifically, Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe."

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the Grants Officer.

Page 10 of the SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 and approved by the SAEDF Board and USAID states that the fund shall not invest in ventures or transactions involving mining.

Condition:

On July 2, 2002 SAEDF disbursed $500,000 (which they subsequently recovered) for a proposed investment in the Ruashi Copper-Cobalt Mine. The transaction however, resulted in a foreign exchange cost of $11,677 to SAEDF. This mine is situated in the Democratic Republic of Congo (DRC), which did not encourage the creation and expansion of indigenous emerging enterprises in the Southern Africa region.

The initial site visit was performed on the 2nd of July 2002. Three employees from SAEDF joined three promoters on a chartered flight to the DRC. SAEDF paid $11,294 relating to a portion of the cost of this flight and accommodation expenses.

Cause:

- The condition is as a result of wilful non-compliance to the Grant Agreement by the former CEO.

Effect:

- SAEDF invested in a country outside the area specified in the Grant Agreement and in an industry prohibited by its Investment Policies Guidelines and Procedures Manual. SAEDF recouped the investment that was made in the company but incurred unallowable expenses of $11,294 and a foreign exchange loss of $11,677.

Recommendation:

- The Contracting Officer should determine the allowability of $22,971 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment:

See Appendix R1 SAEDF's Wachovia account statement and general ledger.

On January 27, 2003, SAEDF received US$11,657.00 from Ruashi to cover Forex losses incurred in the transaction.

As a technical matter, it must be noted that the Grant Agreement forbids investing outside the specified eleven South African countries, not travel to such unspecified countries.

KPMG's additional work performed:

Reviewed a copy of the bank statements for the SAEDF Japanese US reflow – Wachovia account. It is evident from the statement that an amount of $11,657 was deposited on the 27th of January 2003.

KPMG Conclusion:

The exchange loss of $11,657 was recovered and this finding has been removed.
The cost of travel of $11,294 to invest in an unspecified country, remains a valid questioned cost

Appendix 4 Status of prior year audit recommendations

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Appendix 4

Status of prior year audit recommendations

February 2005

This report contains 3 pages

Appendix 4

KPMG

Appendix 4 - Status of prior year audit recommendations

1 External Auditors (Deloitte & Touche)

Legend

✓ = Item resolved
× = Item not resolved
☺ = Item partially resolved

	Finding	Status	Comment
1	**Grant agreement** Per the Grant Agreement SAEDF is required to submit SF 272 reports and cashflow projections to USAID within 15 days of the end of every month. It appeared that the documents were not timeously submitted during October 1997 to June 1998. (1998)	×	Based on work done it appeared that the SF 272's were not submitted within 15 days after every month end. We could also not locate the SF 272 for certain periods. *(See Appendix 2 note 1.10 and Appendix 3 note 1.22)*.
2	**Recognition of income** The recognition of commitment fees, closing fees and application fees was not consistent. (2000/2001)	×	The situation has not changed. Commitment fees, closing fees and application fees are still not being consistently recognized. SAEDF board had however taken a decision that fees raised would be at discretion of management.
3	**Interest income** Interest on term loans was only raised in the month when the cash was received. (2000)	✓	Interest is now being accrued on a monthly basis.
4	**Equity accounting** In terms of the accounting policies stipulated by the Fund's policies and procedures, the Fund should equity account investments between 20 to 50 percent. Management maintain that equity accounting the results of investees would be misleading due to nature of the investments and that the Fund's Policy and procedure manual would be updated to reflect this change. (2001)	×	The policy and procedure manuals have not been changed.

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5	**Valuations** There were no standard procedures in place for performing valuations of investments. There was also no evidence of review of the valuations that were performed, by an independent person. (2000)	☺	During 2001 & 2002 independent valuations were performed on the investments. There is, however, still no formal policy regarding the valuation of investments.
6	**Information from investees** No financial information was obtained for Eerste Rivier Medical Centre from the date the investment was made until November 1999. Management had agreed to assist investees that were experiencing difficulty in producing the necessary information timeously, by designing and implementing an accounting system and a system of internal control. (1999)	×	There was no evidence that assistance was ever provided to investees. Some investees were still submitting financial statements late.
7	**Purchase of alcohol** Purchase of alcohol was made by SAEDF, to the extent deemed necessary to conduct its business, using program funds. Written approval was not obtained from USAID to purchase alcohol. (1998)	×	Alcohol was still being purchased in years after 1998 without express USAID approval.
8	**Site visits to investees** Site visits to investees were done on an ad-hoc basis. Reports detailing the outcome of such visits were not always prepared. Management agreed to implement a strategy for portfolio management, which would indicate the standard procedures relating to site visits. (2000)	×	The strategy for portfolio management has not been done and site visits were not done regularly for 2001-2002.
9	**Monitoring policy** There was no monitoring policy in place and one of the senior investment vice-presidents had agreed to implement a stringent monitoring policy. (2000)	×	No investment monitoring policy has been developed or implemented as promised. Additionally, for the period subsequent to 2000, which KPMG reviewed, little or no investment monitoring was performed and its impact was ineffective in preserving and enhancing the value of the Fund's investment portfolio.

It should be noted that no final management reports were received for the years ended September 30, 2002 and 2003.

Appendix 5 SAEDF responses

KPMG/USIG Audit
Final Report – Final Draft Management Responses (clean)

Appendix 2 – Summary of findings

1. DETAILED FINDINGS – INTERNAL CONTROL ISSUES

1.1 Bonus payments

Management comment:
Historically SAEDF bonuses are approved by the Chief Executive Officer, in consultation with the other departmental heads. The Chief Financial Officer approves and reviews all salary-related expenditures, reconciliations and journal entries. As the Chief Executive Officer, Chief Financial Officer and Vice Presidents are signatories to the Southern Africa Enterprise Development Fund ("SAEDF") bank accounts no payment can be made without their viewing the payment documentation. SAEDF is currently reviewing its Human Resources ("HR") policies and will include senior management review and approval in the HR Manual.

The auditor's statement is incorrect. All SAEDF bonuses are presented, discussed and approved by the SAEDF board Human Resources Committee. In addition, the SAEDF board reviews the SAEDF financials on a quarterly basis and any variances above budget are questioned and explained by the Chief Financial Officer and Chief Executive Officer.

Management disagrees that the HR policies were poorly designed. It would be more correct to state that the HR policies were adequate, yet they were not always adhered to.

Management agrees with the effect and recommendations.

1.2 Authority of CEO

Management comment:
SAEDF bonuses are approved by the Chief Executive Officer in consultation with the other departmental heads. However, it is correct that the Chief Executive Officer had the final say on bonus (and salary increase) figures and percentages.

Management agrees that certain staff received excessive bonuses.

As with bonuses and salary increases it is agreed that the Chief Executive Officer did have the final authority (at executive/management level) with regard to terminations.

Management does not feel it can comment on the CEO's dominating and intimidating management style.

It is agreed that the Chief Executive Officer acted incorrectly in the two instances mentioned. It was these, and other, issues that eventually led to his termination.

Contracts were signed with the US legal counsel-approved contract.

The Chief Executive Officer performance was discussed during the Executive Sessions of the SAEDF board meetings. The Chief Executive Officer was usually requested to leave the room while his performance was reviewed. For example in the board minutes of November 1999 the Chief Executive Officer was warned that his performance was directly linked to the Fund's performance.

Management agrees with the recommendations.

1.3 Monitoring of budget

Management Comment:
SAEDF budgets are approved by the board. SAEDF submits quarterly Treasurer's Reports to the Audit Committee of the board, which includes detailed financials as well as detailed narrative on any expenditure above budget. Management are questioned about the reports during the SAEDF board meetings. SAEDF Finance and accounting also adopted a "real-time" approval process whereby expenditure could be checked against budget before approval was granted. The system involved the Financial Manager monitoring all expenditure via the purchase requisitions. Any expenditure resulting in the budget being exceeded would have to be approved by the Chief Financial Officer, Chief Executive Officer or Senior Vice President. These expenses would usually have been unavoidable, yet necessary, expenses.

It is unclear what income statement accounts the auditors used for the calculation of the differences as SAEDF's figures differ as follows:-

- 1998: General and Admin was $51,608 above budget, mainly due to telecommunication expenses being $33,038 above budget.
- 1999: General and Admin was $59,330 above budget, mainly due to an $88,837 provision for bad debts. No budget amount was provided for bad debts.
- 2000: General and Admin was $309,605 above budget, mainly due to a $300,727 provision for bad debts. No budget amount was provided for bad debts.
- 2001: General and Admin was $271,953 above budget, mainly due to a $385,967 provision for bad debts, where no budget amount was provided (therefore expenditure was actually below budget). Board expenses were $69,417 above budget, which caused business expenses to be above budget. Board expenses were extremely difficult to budget for as the location and attendees were unknown at the time of preparing the budget.
- 2002: The format of the income statement was changed by the Chief Financial Officer making comparisons to prior years difficult (certain expense accounts were included under different category heads to prior years). SAEDF also had an independent party value its investment in Loita at a cost of $37,600 (also not budgeted for). As in 2001 business expenses were above budget as a result of board expenses ($99,125 above budget).
- 2003: Expenditure was above budget as a result of the Chief Executive Officer termination expenses ("restructuring costs").

Note: The statement that restructuring costs were not budgeted for "at all" is self-explanatory. Budgeting for the expenses would have meant that SAEDF intended to terminate the Chief Executive Officer's services prior to knowing of any offences. The expenses were incurred as a direct result of legal action taken by the former Chief Executive Officer against SAEDF and were therefore impossible to forecast.

Management only agrees with the comment with respect to board expenses. For all other expenses management had control over and monitored variances via the monthly and quarterly financial reports issued to management and the SAEDF board.

Recommendation 1 is already in place, and has been for some time. Previously the Chief Financial Officer approved any possible excess expenditure and as most expenses in question were approved by the Chief Executive Officer or relate to board expenses (also approved by Chief Executive Officer) management does not see how the process will differ from the one currently in place.

1.4 Excessive number of journals

Management Comment:
Management disagrees with the comment. In 1998 the journals were a direct result of the process undertaken by the newly established full-time Finance and accounting department - of installing Accpac correctly. Prior to this the SAEDF accounting functions were outsourced to Deloitte and Touche. The Accpac system installed at the time only print out a detailed trial balance. SAEDF undertook to reconstruct the entire system. A new chart of accounts, new reporting formats and new cost centres were created. As the previous system was useless as a reporting tool management created a parallel database with the new system. The trial balances were reconciled and for a few months the systems were run in parallel (all entries were captured into both databases). Any journal entries had to be captured into both databases according to the respective database account codes. The journals were a result of "splitting" the entries in the old system into more specific categories in the new system. For example the old system had an expense item called "travel", while the new system too had travel, but it was further split into accommodation, airfares etc. SAEDF therefore had to allocate every travel related item into the new categories – via journals. In later years the journals were partly due to misallocations, or errors in capturing. However, as the Financial Manager approved all batches prior to posting, the entries were usually a result of management (Chief Financial Officer) disagreeing with the allocation and requesting the Financial Manager to reallocate the entry. As an additional control SAEDF utilized control accounts in the balance sheet. Any payroll, staff debtor, trade creditor, unknown expenses etc were allocated to these accounts and only expensed to the income statement (via journals) when the relevant reconciliation had been performed or the unknown expenditure clarified.

The journals were performed to provide more accurate information and therefore more meaningful financial statements, and therefore the end justifies the means (see above).

Management disagrees that any of the staff involved lacked knowledge.

Management feels that the drawing up of a formal journal policy is unnecessary. In future the Chief Financial Officer will review all journals generated by the accountant and Financial Manager.

Supporting documentation is attached to journals in all instances, or the reference number of the original payment is given on the face of the journal. The majority of the disputed journals were reallocations or allocations of prepaid expenditure. In both cases it is completely unnecessary to attach anything but the general ledger printout or the reconciliation.

Suitably qualified staff was employed by SAEDF and the individuals' qualifications can be found in their personnel files.

1.5 Monitoring of telephone costs

Management Comment:

SAEDF is monitoring telephone usage. In 1999/2000 SAEDF Finance and accounting department identified that telephone costs were excessive, even though SAEDF at the time had over 30 employees. SAEDF purchased a telephone monitoring system that could monitor telephone calls per extension. Each employee was given a separate extension as well as a phone locking number, to prevent other employees from using their extension. The total costs for all extensions equalled the Telkom account for the particular month. Each month Finance and Accounting reviewed the printouts, per extension, and highlighted the following:

- Calls of excessive duration,
- Calls to foreign countries not in the SADC region,
- Calls to SADC countries not relevant to the particular department or investment group, and
- Any other frequently recurring numbers (especially cell numbers).

The costs per extension were captured into an excel schedule to show trends in phone abuse. Employee's whose monthly charges were excessive were highlighted to their relevant manager, who in turn spoke to the employee. If the employee continued to make excessive calls the charges were deducted from their salaries (see L. Isaacs and L. Khoza). Immediately after instituting the above process total phone charges reduced.

SAEDF has a long established formal expense claim policy. Staff are permitted 2 personal calls, paid by SAEDF, while travelling. All other calls are either personal or business. Personal calls are identified as such by the traveller and deducted from the M&IE travel advance given to the employee. The head of department then approves the expense claim as proof of acceptance of the expenditure. Any questionable costs are discussed with the employee and if no satisfactory explanation is given are deducted from the travel advance too. Business calls are paid by SAEDF. As with annual leave this system also relies on staff honesty and integrity in identifying personal/business expenses. SAEDF is satisfied with the controls.

Management disagrees (see above) that poor management practices existed and there was no attempt to reduce costs.

There is no need to request this service from Telkom as the phone monitoring system can do this. All SAEDF telephone costs are evidenced by itemized bills.

Almost every hotel SAEDF travel to provides itemized billings per room number. All employees are required to identify all (not only telephone calls) business and personal expenditure on their hotel bills. SAEDF will also review its cell phone reimbursement policy to only reimburse SAEDF staff for actual business calls.

1.6 Timekeeping

From 1998 to 2003 the South African and expatriate payrolls were prepared by the Financial Manager, approved by the Chief Financial Officer and paid by a payroll service provider. SAEDF forwards all earnings and deductions on a payroll spreadsheet to the service provider. The service provider calculates employee and company taxes, according to legislation, deducts them from the income and transfers the net salaries into the employees' bank accounts. In some instances SAEDF transfers the funds, but the process is as above. Payrolls were reconciled (expense accounts and balance sheet control accounts) on a monthly basis. The reconciliation's are prepared by the Financial Manager and approved by the Chief Financial Officer. All salary journals are prepared by the Financial Manager and approved by the Chief Financial Officer. At month end the Accountant and Financial Manager prepare a "Monthly control checklist". The list details various monthly processes that must be approved and reviewed. The Financial Manager reviews and signs for work performed by the Accountant, and the Chief Financial Officer approve and review the work performed by the Financial Manager. However, on review it appears that some of the checklists have not been reviewed by the Chief Financial Officer. Conversely SAEDF reviewed the payroll files from October 1997 to September 2003 and found the following:

- Expense account reconciliations were performed for every month up to February 2002.
- Of these reconciliations the Chief Financial Officer or Financial Manager reviewed and signed all but 6 of them.
- Payroll schedules were available for every month from February 1998 to September 2003.
- The payroll clearing accounts were reconciled for every month from September 1998 to September 2002.
- Payroll journals were posted for every month, but 2, from October 1997. The journals were processed to reconcile the clearing accounts and expense accounts to the actual funds disbursed from the SAEDF bank accounts.

Management agrees that no employee activity reports have been used. However, staff attendance was monitored via leave schedules. Staff are required to submit leave schedules for prior approval to their departmental head. Once approved they are forwarded to the leave administrator to update the leave schedules. Leave days owed to staff are displayed on their monthly payslips. Excessive leave days taken, contrary to labour legislation, are deducted from staff pay. The system was reliant on staff honesty and integrity and there was therefore a possibility of manipulation.

The condition that there was no segregation of duties is incorrect (see condition 1 above).

Management agrees with condition 5.

Condition 6 is incorrect. Salary schedules are located in the payroll files and are also still kept by the Financial Manager in soft copy.

Management disagrees with the cause. Process detailed above shows adequate review, control and segregation of duties.

SAEDF's Chief Financial Officers previously approved all payroll reconciliations and journals, however since 2003 no Chief Financial Officer has been employed by SAEDF and the Financial Manager has therefore approved these. In the future the Chief Financial Officer or Chief Executive Officer (in the absence of a Chief Financial Officer) will be required to approve the payrolls. The Chief Financial Officer/Chief Executive Officer will also review the Monthly Control Checklist.

SAEDF is in the process of drawing up an employee review and compensation system. SAEDF will discuss, with USAID, methods of record keeping other than the employee activity reports.

Management deems the former system for preparing payroll satisfactory. In this system the Financial Manager prepares the payroll, Chief Financial Officer approves and a consultant processes. SAEDF has already advertised for the position of Chief Financial Officer and expects to fill the position as soon as possible.

1.7 CEO benefits

Management Comment:
The SAEDF board, including USAID, approved a US$1,200 motor vehicle allowance for the Chief Executive Officer. At the time the monthly ZAR lease payments were equivalent to the US$1,200. The lease payments were paid by SAEDF and allocated against the travel allowance as part of the Chief Executive Officer's salary deductions. The US$1,200 was effectively paid to the leasing company. The board also approved a US$4,000 housing allowance for the Chief Executive Officer. At the time the ZAR equivalent (+-ZAR 18,000) was deemed reasonable for the level of residential housing approved for the Chief Executive Officer. In latter years the devaluation of the ZAR increased the figure in ZAR-terms. The US$33,000 per annum education allowance was included in the contract for the employee in question when he was appointed to the position of Chief Operating Officer (January 2, 2001). It was unclear which year the allowance related to. Was it SAEDFs financial year, a calendar year or year from the Chief Executive Officer's contract inception? SAEDF, with consultation with the SAEDF board, decided to average the allowance over the Chief Executive Officer's contract (in other words it could not exceed US$66,000 for the life of his contract). The surplus amounts charged were unallowable and were part of the SAEDF counter-claim in the resulting lawsuit with the terminated Chief Executive Officer.

It is incorrect to state that there was Board oversight.

Management agrees with the recommendations.

1.8 Security for loan

Management Comment:
The Chief Executive Officer approved the funding of "Social development" investments. These investments could not exceed ZAR1 million and could therefore be approved by the SAEDF Internal Investment Committee ("SIIC"), and ratified by the board Investment Committee telephonically. The approval process was shortened as the deals could be approved by the SAEDF Internal Investment Committee without extensive due diligence or a detailed board book. The deals did not need to provide SAEDF with the desired hurdle rate or 15%, only the original capital investment.

Management agrees with the recommendation.

1.9 Redemption of shares

Management Comment:
See investment responses.

1.10 SF-272

Management Comment:
It is agreed that SF272's have not been submitted since February 2003 and SF269's since June 2003. Management agrees that the returns were submitted after the 15th of the following month (see explanation below).

SAEDF reviewed the dates in question and only August and September 2002 were missing. The returns can be viewed in the USAID files held by Finance and Accounting. Management agrees that the returns were submitted after the 15th of the following month (see explanation below).

SAEDF reviewed the dates in question and none of the returns were missing. The returns can be viewed in the USAID files held by Finance and Accounting. Management agrees that the returns were submitted after the 15th of the following month (see explanation below).

Management agrees with the auditor's cause statement.

Due to delays in receiving bank statements SAEDF Finance and Accounting department set the following monthly deadlines:

- 7th of the following month – closure of prior month,
- 10th of the following month – completion of trial balance, income statement and balance sheet (Accpac generated),
- 15th of the following month – completion of all journals, reconciliations and the monthly/quarterly reports.

In this way the SF-272 (and SF-269) would be prepared using final monthly figures, after reconciliations and corrections. These dates were communicated verbally to USAID who gave the indication that they were not concerned about the late submissions. The only stipulation at the time was that SAEDF would not be permitted to draw any funds down if the returns were not up to date.

In future management will "cut off" the processing of the month's transactions earlier than was previously done. In this way the financials will be finished earlier and therefore the SF272 would be submitted earlier. It must be noted that this will lead to certain transactions appearing in the incorrect month, thereby resulting in "over-" and "under-" provisions for certain expenditures. If possible management will post accruals for orders placed (per the completed purchase orders) but not yet paid for. The Monthly Control Checklist has been used since the 1997/8 financial year and will be reintroduced and enforced (with Chief Financial Officer/Chief Executive Officer review).

1.11 Investment approval and disbursement

Management Comment:
See investment responses.

1.12 Authorisation of bank transfer letters and cheques

Management Comment:

The bank transfer in question was a payment to the SAEDF appointed consultant for the USAID semi-annual review ("SAR") report. The consultant was appointed by the Chief Executive Officer and a contract was signed by the SAEDF Chief Executive Officer and the consultant - indicating reporting requirement and payment terms. SAEDF policy, if the regular "A" signatories are travelling, was that one of the "B" signatories not travelling was temporarily nominated as an "A" signatory. In this case the Vice President was nominated as the temporary "A" signatory and the Financial Manager the temporary "B" signatory. The instruction was signed by the Chief Executive Officer and forwarded to the banks. The payment therefore had the required Chief Executive Officer approval.

It is possible that the cheque was missed by one of the signatories and forwarded to the payee. However the bank in question was at fault if it paid the cheque, as it did not comply with the SAEDF standing instruction – that 2 signatories sign all cheques.

It is understood that no employee can approve an amount above US$50,000. This being so would mean that the auditors comment, regarding the US$150,000 limit, is incorrect. The auditor's statement on bank transfer approvals is illogical. It is unclear which SAEDF personnel were approached and what relevance the statement is as invoices are authorised for payment, not bank transfers.

Management agrees that compliance with policies and procedures is essential but feels that this has been done and was done satisfactorily.

2. Detailed findings – Internal control issues (Material weaknesses)

2.1 Appointment of employees

Management Comment:
Example 1 - SAEDF utilized a formal recruiting process for the majority of positions, until recently when SAEDF awarded an agency the sole mandate to recruit for SAEDF. Recruitment agencies were approached to forward candidates. The departmental head and the Chief Executive Officer interviewed the candidates and the most suitable candidate was eventually appointed. On certain occasions staff were promoted from junior positions or moved from other departments. Historically, SAEDF associates and analysts have always been recruited with accounting degrees. Vice Presidents and Senior Vice Presidents usually were required to have further qualifications (possibly an MBA).

Example 2 - The Finance and Accounting staff that moved to investments in 2001 and 2002 did so as their accounting systems and financial controls experience was deemed necessary to assist with turnarounds for certain SAEDF investee companies. A separate investment group was set up to monitor the "troubled investments portfolio".

Example 3 – Management agrees.

Management agrees with the cause.

Management agrees with the recommendation. Previously the potential employee verification was done by the recruitment agency, as SAEDF did not possess the necessary expertise.

2.2 Design of policies and procedures – Travel

Management Comment:
This statement is partially correct. In later years staff were required to attach the air ticket stub and/or the boarding pass. It was decided by Finance and Accounting that the air ticket was no guarantee that the flight had actually been taken and therefore the boarding pass had to be attached to the claim. The policy was also reliant on SAEDF Finance and Accounting department common sense e.g. if a hotel bill from the SADC country travelled to was attached to the expense claim then it was obvious that the person had taken a flight, or if 2 staff members travelled together and one had misplaced his ticket stub then it was not insisted upon for that person if the travel details were confirmed by the other. Management also reviewed all travel requests prior to departure (via the travel authorization form) and payments after returning (via the monthly/quarterly management reports).

Each investment group PA, as well as Finance and Accounting, kept copies of all travel forms. On inspection it was discovered that some forms were missing. It is not clear which per diems the auditors regard as excessive as the rates were strictly adhered to. It is possible that per diems for accommodation may have been approved if the trip was urgent and no cheaper accommodation was available. To management's knowledge no trips (excluding board meetings) were approved where the lodging per diem was above the Policies and Procedures maximum allowable rate.

In very few instances investment staff were required to travel with little or no notice. The trips were verbally approved by the Vice President/Senior Vice President and when the PA had the opportunity to complete the form it was completed and forwarded to the department head for signature. Senior management received a detailed monthly report

(Accpac and management report) showing the business trips taken during the period. Had a trip appeared that the Chief Financial Officer and Chief Executive Officer never approved then they would have queried the trip during their management meetings.

SAEDF cannot comment on the charge without reviewing the relevant documentation.

In the past SAEDF credit card policy did not require senior investment managers to approve statements. The person who used the card attached all vouchers and signed the statement as acceptance of the itemized expenses. The senior manager would then review the statement, vouchers and charges. He would discuss questionable expenses with the employee and deduct any unresolved expenses from the expense claim. Management agrees that the manager should have been required to sign the statement too to indicate his approval. SAEDF will enforce this in future.

Management agrees with condition 7. However, this and other Chief Executive Officer expenses, were queried by Finance and Accounting and were highlighted to the auditors during the subsequent internal audit.

It is understood that the charge/trip in question relates to the Chief Executive Officer during 2002. It could not be established why the London expenses were paid for by SAEDF. However these expenses were queried by Finance and Accounting and were highlighted to the auditors in detail during the internal audit.

Purchase of alcohol was approved by the SAEDF board (only for business-related meals) and was to be deducted from non-grant funds. All movies and other non-business expenses incurred during SAEDF travel were deducted from the M&IE advance paid to the staff member, and therefore effectively paid by the employee.

Management agrees that the no-shows were unfortunate. However, the organizing of the SAEDF board meetings has always been extremely difficult. SAEDF board members occasionally cancel their attendance at SAEDF board meetings, due to various reasons, resulting in SAEDF having to pay for the room/s.

SAEDF regards their travel policies as satisfactory. However, the additions to the existing policies that SAEDF adopted informally should have been formally incorporated into the policies and procedures manual (instead of via e-mail or internal memorandum).

Management agrees with cause 2.

Management and the SAEDF board identified the need to review the internal controls and was one of the reasons for appointing an internal auditor in 2002. It is agreed that the travel policies and procedures should be constantly reviewed and updated. Management also agrees that the new Chief Financial Officer will be tasked to improve these areas of concern.

Management agrees with recommendation 2.

2.3 Completion of policies and procedures – Human resources

Management Comment:
Although SAEDF previously conducted personnel reviews it is agreed that the policy should have been more extensive and formalized. Certain decisions that were taken by management should have been included in a formal policy. SAEDF management is currently implementing a formal appraisal and remuneration policy/system, which will

rectify the issues mentioned by the auditors.

Management disagrees that the use of informal appraisal and recruitment processes can be regarded as "poor management practices".

Management agrees with the recommendations. Management is currently in the process of implementing this and should have the processes in place within the next six months.

2.4 Design of controls – Bank transfers and Authorisation limits

Management Comment:
Incorrect auditor condition. SAEDF adopts the same mandates with regard to bank transfers as it does with cheque payments. SAEDF requires all bank transfers to be signed by 1 "A" signatory and 1 "B" signatory. Prior to sending the fax all bank transfers are reviewed by the Financial Manager (who initials and dates the back of the transfer letter).

The example of fraud that Auditors mention did in fact occur at SAEDF in 1999. The error was detected by Finance and Accounting the following day and the staff member was subsequently dismissed. The fault was not an SAEDF error but an American Express error as they failed to comply with the SAEDF signature mandates and issued foreign currency to a junior employee (who was not even a signatory).

Management disagrees with recommendation 1. It is impractical to suggest that SAEDF's banks confirm all transfers, especially as SAEDF also makes payments from a US-based bank.

SAEDF management did consider the use of Electronic Fund Transfers ("EFT") but at the time it was decided that their use was still risky and SAEDF decided to continue with its existing system of cheques and bank transfers. Management has reviewed the use of EFTs and has received board approval to effect EFT payments.

Management disagrees with recommendation 3. It is not understood how changing authorization limits will have any effect on controls. SAEDF considers their authorisation limits as satisfactory.

2.5 Disaster recovery plan

Management Comment:
Management agrees with condition 1. The SAEDF server is backed up daily and tapes are supposed to be taken by the Office Manager offsite each day. On investigation it was discovered that the Office Manager had failed to do a few backups and also failed to take the backup tapes offsite. The Office Manager was subsequently verbally warned and informed of the potentially serious consequences of his actions/inactions.

Management agrees with condition 2. SAEDF did not have any form of disaster recovery in 1997 as all admin and accounting was outsourced to Deloitte and Touche. SAEDF subsequently contracted the services of an IT consultant to install, monitor and update all of SAEDF Information Technology.

Management understands their security responsibilities but the decision to task the Office Manager with the responsibility was possibly an error. Management will institute review of the backup procedures by a senior official.

Management agrees with the recommendation.

2.6 Personnel documentation

Management Comment:
Management agrees with condition 1. No specific personnel information was required in the past, except for a copy of the employee's employment contract. Management will incorporate a list of specific documentation requirements into the new HR Manual.

Condition 2 is incorrect. On review of the personnel files employee files were present for all SAEDF past and present staff. It must be mentioned that the current Finance and Accounting staff had not adequately safeguarded the files and had misfiled numerous documents. The documentation has since been re-filed and is kept in a locked office.

Management agrees with condition 3. Finance and Accounting have completed updating the employee files for all current and past SAEDF staff. Numerous job descriptions and curriculum vitae's were found and filed in the appropriate files. Updated job descriptions will be included as part of the updated HR process currently being undertaken.

Management agrees that the recent Finance and Accounting staff have not adequately administered and safeguarded the personnel files. This error has since been rectified.

Management agrees with the recommendation. SAEDF management is currently undergoing an HR review and will incorporate the recommendation regarding required documentation as stipulated by labour legislation.

2.7 Income: Equity accounting

Management Comment:
The issue was raised in prior years by SAEDF's external auditor. It was management's decision that the use of equity accounting would be misleading as, at the time, the majority of SAEDF's investments were early stage or start-ups. These entities were virtually all loss making and to include these losses in SAEDFs financials did not make sense. SAEDF decided to adopt the European Venture Capital Association ("EVCA") guidelines for valuing early stage investments at cost. As the annual financial statements were unqualified and signed by the external auditors implies that they were in agreement with SAEDFs view.

Management agrees with the cause (as above).

Management agrees that the SAEDF Policies and Procedures should be amended.

2.8 Authorisation of expenditure

Management Comment:
The person requisitioning the purchase has to be the person who signs the invoice, as his signature on the invoice is evidence of his acceptance of the good/service. There is sufficient segregation of duties, as the person requisitioning the order does not approve the requisition. The second segregation of duties occurs when the Financial Manager or Chief Financial Officer signs the purchase order. The SAEDF Procurement Manual details the segregation of controls extensively. SAEDF did complete purchase orders for

promoters to achieve the forecasts given in the due diligence report, during the period between the receipt of the funding application and the final disbursement of funds, i.e.18/02/1997 to 14/05/1998;

There were no signed audited financial statements on file for ERMC for the financial years ended 30 September 1999 and 30 September 2000 even though SAEDF had invested $900,000 in ERMC.

Furthermore, there are only three quarterly reports, prepared after disbursement of funds, on the investment file.

Cause

SAEDF had no formal monitoring and capacity building policy to ensure that the value of the investment portfolio is maintained. Investment staff neglected to monitor the investment once the funds had been disbursed.

Effect

- As a result of the poor monitoring SAEDF investment staff did not identify a number of irregularities at ERMC. ERMC was liquidated and SAEDF lost the total investment ($900 000) they had made in the company.

Recommendation

- The Contracting Officer should determine the allowability of $900,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

proceeded in acquiring further shares to the value of $2,946,138 in Maxiprest The total investment in Maxiprest amounted to $3,771,404.

Cause

m The condition is as a result of the CEO initially investing without Board approval, and then deliberately not adhering to the directors' decision not to acquire further shares in Maxiprest

Effect

- The investment in Maxiprest was made without Board approval and is accordingly an ineligible cost.

Recommendation

- The Contracting Officer should determine the allowability of $170,240 (actual loss suffered) in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

The then CEO was disciplined by the board and eventually terminated.

*1.29 **Eerste River Medical Centre (Cape) Ltd ("ERMC")***

Monitoring of investment

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements states that the success of the Fund will be judged on the extend to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition

SAEDF did not monitor the financial position of ERMC or the strategies put in place by it's

Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the abovementioned SAEDF Investment Policies, Guidelines and Procedures Manual requires that the due diligence process must be performed prior to approval and disbursement

Condition

m The due diligence for the investment in Maxiprest was conducted after the initial investment of $825,265 had already been made.

Cause

m The condition is as a result of **willful** non-adherence to the Investment Policy by the former CEO.

Effect

m The investment in; Maxiprest was made in contravention to the SAEDF investment policy and resulted in a loss of $170,240 to SAEDF and is accordingly an ineligible cost.

Recommendation

- The Contracting Officer should determine the allowability of $170,240 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

1.28.3 Approval of investment

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that "the full board shall Ratify all investment decisions made by the CEO and the investment committee of the board".

Section E of Modification No. 06 to the Grant Agreement further requires that the application of the policies to individual investment decisions will be based on the business judgment of the Fund's board of directors ***and*** executive management,

Condition

SAEDF purchased its initial shares in Maxiprest during April 2002, without any Board of Directors approval to purchase the shares.

At the Board meeting in June 2002 management requested approval to purchase Maxiprest shares. This approval was not granted.

Despite no approval being given for the Maxiprest investment, SAEDF management

[redacted]

[redacted]

1.28 ***Babete /Maxiprest ("Maxiprest")***

1.28.1 Target group

Criteria

Paragraph E.I of Modification No. 06 to the Grant Agreement states that the Fund will invest in enterprises that are disadvantage^ by their inability to attract long-term capital investment from existing commercial sources

Condition

m SAEDF invested $3,771,404 in Maxiprest, which is listed on the Johannesburg Stock Exchange (JSE). Enterprises listed on the JSE are large enterprises and accordingly are not considered to have difficulty attracting long-term capital investment

Cause

- Present SAEDF management were unable to state why the decision was taken to invest in a listed company.

Effect

- $3,771,404 was invested in a manner that did not further the goals of the award. The investment of $3,771,404 is therefore raised as an ineligible questioned cost. On sale of the shares in Maxiprest, the actual loss to SAEDF on this investment was $170,240.

Recommendation

- The Contracting Officer should determine the allowability of $170,240 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

1.28.2 **Performance** of due diligence

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures

Criteria

Section D.I of Enclosure 2 to the Grant Agreement states that "The Fund's primary activity will be to provide financial resources and services through the investment of risk capital in profitable opportunities throughout Southern Africa."

Paragraph G of Modification No. 06 to the Grant Agreements further states that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

Condition

SAEDF did not monitor the investment in Ahanang and disbursed funds ($34,120) to Ahanang subsequent to the company having ceased trading.

Furthermore, SAEDF did not secure registered bonds over the assets of Ahanang to insure itself against any losses that may be incurred.

Cause

m The condition is due to poor management oversight of the investment portfolio.

Effect

m The value of the investment portfolio was reduced by $34,120 and SAEDF lost this amount, as they did not have any security over the investment.

Recommendation

- The Contracting Officer should determine the allowability of $34,120 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

7.27 *Ahanang* ***Construction CC ("Ahanang")***

1.27.1 **Approval of investment**

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that "the full board shall Ratify all investment decisions made by the CEO and the investment committee of the board".

Section E of Modification No. 06 to the Grant Agreement further requires that the application of the policies to individual investment decisions will be based on the business judgment of the Fund's board of directors ***and*** executive management.

Condition

- The minutes of the SAEDF Board and investment committee of the Board do not indicate that the investment committee of the board approved the investment in Ahanang or that the SAEDF Board ratified the investment

Cause

- Present SAEDF management were unable to state why a unilateral decision was taken without the required approvals.

Effect

- The lack of approval for the investment results in the investment of $5,000,000 being ineligible and is therefore a questioned cost.

Recommendation

- The Contracting Officer should determine the allowability of $5,000,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

1.27.2 **Maintenance of records**

1.26.3 Targetgroup

Criteria

Paragraph E.I of Modification No, 06 to the Grant Agreement states that the Fund will invest in enterprises that are disadvantage by their inability to attract long-term capital investment from existing commercial sources

Condition

- ABCH is listed on the Botswana and Zimbabwe Stock Exchange. Enterprises listed on stock exchanges are typically large enterprises and accordingly are not considered to have difficulty attracting long-term capital investment

Cause

- Present SAEDF management were unable to state why the decision was taken to invest in a listed company.

Effect

m $5,000,000 was invested in a manner that did not further the goals of the award. The investment of $5,000,000 is, therefore, raised as an ineligible questioned cost.

Recommendation

- The Contracting Officer should determine the allowability of $5,000,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

1.26.2 Investment limits

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[1]

Condition

- On 27 August 2002 SAEDF made an investment of $5,000,000 in ABCH, which is in excess of the policy amount

Cause

- Management believed that the limits, as stated in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorization limit to $5,000,000 during a Board meeting held on 27 February 1999. However, this increase was never submitted to USAID for formal approval.

Effect

- The investment of $5,000,000 was not properly authorised. The amount in excess of $1,000,000, i.e. $4,000,000 is therefore questioned as an ineligible cost.

Recommendation

- The Contracting Officer should determine the allowability of $4,000,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

Detailed Findings

L26 ***African Bank Corporation Holdings ("ABCH")***

1.26.1 Approval **of investment**

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states, "The full board shall ratiiy all investment decisions made by the CEO and the investment committee of the board".

Section E of Modification No. 06 to the Grant Agreement further requires that the application of the policies to individual investment decisions will be based on the business ~~judgement~~**judgment** of the Fund's board of directors *and* executive management.

Condition

m The minutes of the SAEDF Board and investment committee of the board do not indicate that the investment committee of the board approved the investment in ABCH or that the SAEDF board ratified the investment, i.e. management made the investment without the required approval.

Cause

m Present SAEDF management were unable to state the reason as to the cause of the investment not being approved.

Effect

The lack of approval for the investment of $5,000,000 results in it being ineligible and therefore a questioned cost.

Recommendation

- The Contracting Officer should determine the allowability of $5,000,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

SAEDF's Board of Directors approved this transaction on Monday, December 3, 2001. See Appendix A1 for copy of board minutes containing the pertinent resolution.

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the course and was not concerned if the employee left SAEDF soon after completing the course.

Restructuring has no relevance on the training process. In 2003 SAEDF was instructed to "carry on business as usual" during the Chief Executive Officer lawsuit and subsequent USAID audit. Had SAEDF cancelled training courses that staff were entitled to would have resulted in further staff morale and retention problems. SAEDF has always had a favourable training policy and sees the US training course as a way of rewarding and developing the employee. It must also be mentioned that the US course frequently attended is the US Venture Capital Association Conference, which relates directly to SAEDF's business.

Management agrees with the auditor's cause.

Management regards the expenditure as allowable for the reasons mentioned above.

1.25 Program income

Management Comment:
The SAEDF accounting system was maintained by an accounting firm prior to Oct 1, 1997. Reconciliations and records for the period comprised 1 cardboard box and were hopelessly inadequate. From March 1998 the full time department had to reconstruct the department, reports, recons.

Management agrees with condition 2.

Funds were transferred from the various SAEDF bank accounts into the Reflow account on a quarterly basis. If the amounts were significant transfers were done more frequently. At the time of the auditors review it is possible that the transfer had not yet been done, and the Reflow account balance was therefore lower that what it should have been.

Management agrees with condition 4. Management was told to utilize all existing (non-committed) funds for operations and investments before USAID/US Treasury would approve another grant drawdown. As bank reconciliations as well as balance sheet recons were performed every month it appears that the auditors did not refer to the correct documents. SAEDF reviewed to reconciliations and all appeared to be in order.

The 2002 financial year was as above (conditions 3 and 4). The purpose of the reconciliation mentioned was to reconcile the bank balance to the accumulated Reflow account figure. Managements understanding was that this money would eventually be deducted from investment capital payments, which were to be returned to the Treasury, and utilized for sustainability post USAID.

Management agrees with the auditor's cause.

Management agrees with the recommendation.

1.26 to 1.45 – Investments (insert here)

The auditor's cause is incorrect. Management feel that the presentation of final/correct figures to USAID is far more important that the presentation of estimates. The delays were caused in an attempt to capture all expenses in the month they were incurred. In future the month end cut off will be moved a few days earlier so that the financials are completed earlier and therefore the SF272 and SF269 returns submitted on time.

Management agrees. SAEDF will comply with the deadline once the current audit/s are complete and the HR issues in the department have been resolved. Previously, the deadlines were missed as SAEDF wanted to present final/correct figures, instead of closing off the month and having to pass corrections in the following month.

1.23 Appointment of recruitment agencies

Management Comment:
Management agrees with condition a. Management agrees that SAEDF should not have paid the recruitment fee for the Chief Executive Officer. Management is of the opinion that the Chief Financial Officer failed in his fiduciary duties in this regard. He has since resigned from SAEDF. It is not evident why a percentage of 20% was agreed upon and management agree that the percentage was high.

Management agrees with condition b. The decision to appoint one recruitment agency was taken by the, then, Financial Manager and Chief Executive Officer. They decided that the recruitment need of SAEDF would be served best by using one company. This would build a relationship with SAEDF and thereby reduce the time for recruiting new employees.

Management agrees with the auditor causes. However, the expenditure was incurred as a result of the Chief Executive Officer and Financial Manager concluding a contract without the knowledge of the other senior managers. Although the amounts fell within the Chief Executive Officer's authority levels, it would have brought valued input into the contract and eliminated any appearance of a lack of transparency. It is therefore essential that the Chief Financial Officer enforce compliance with OMB Circular A-133.

Management agrees with the recommendations.

1.24 Training

Management Comment:
SAEDF, at the time, could not locate any suitably qualified private equity professionals. The Chief Executive Officer recruited senior staff that had investment experience and decided to train them in the USA – hence the course. The course was an extensive senior management course and the fee was reasonable at the time. There was and still is no comparable course, in terms of quality, in South Africa. SAEDF has always adopted an employee-determined approach to training. While preparing the annual operational budget SAEDF employees decide what courses they would like to attend for the coming year and, with their department heads agreement, include them in the coming year's budget. The departmental head decides if the course will be beneficial to SAEDF and the employee or not. In addition budgeted amounts are provided for US training courses for the investment and Finance and Accounting departments. In 1998 it was SAEDF policy that employees from Financial Manager and above (Finance and Accounting) and Analyst and above Investments) qualified for overseas training once they had been with SAEDF for 2 years. It was SAEDF's view that the employee had already worked off the cost of

SAEDF, via the company credit card. Copies of the hotel bill were attached to the expense claim submitted on return to the office. The expenditure would therefore have been reviewed via the credit card statements, via the expense claim and finally via the detailed monthly "travel" report (included in the Management and Treasurer's Reports).

AT&T charges related to SAEDF board meeting conference calls and the Chief Executive Officer's calling card (used in the USA). As the costs were incurred while calling from the USA to South Africa it is understandable that the costs are high. However the card was utilised, as the call costs were significantly lower than calls made from hotels. It is agreed that there should have been a formalised approval process, administered by the Chief Financial Officer.

The SAEDF board approved the installation of security systems for certain SAEDF employees (see March 2000 board minutes).

The auditor's cause is incorrect. Management does not agree that the costs are excessive, but agrees that costs should be monitored to prevent abuse.

Management agrees with the recommendation.

1.21 Advertising and promotions

Management Comment:
USAID approved that SAEDF could incur such expenditure as long as it was deducted from non-grant income. SAEDF needs to allocate all such expenditure to a separate account so that it can be deducted from non-grant income. Management will perform the reconciliation and prepare a journal entry correcting the error.

The former SAEDF Chief Executive Officer approved the expenditure in order to help promote SAEDF's image in the region. It is understood, as they involve self-promotion, that these expenses cannot be paid out of Grant funds, but can be paid from "Reflow" funds. The expense was correctly allocated to the "suspense" account in the balance sheet. This account kept track of all expenditure that did not comply with OMB requirements. In September 2002 the Finance and Accounting department incorrectly re-allocated the expense to the "promotions" account in the SAEDF income statement.

The auditor's cause is incorrect.

Management regards the expenditure as allowable for the reasons mentioned above.

1.22 SF-272

Management Comment:
The SF 272's for April 2003 to September 2003 have not been completed.

For the period April 2002 to January 2003 only August 2002, September 2002 are missing from the file.

For the period October 1999 to May 2000 all returns are on file. Submission dates are communicated verbally to USAID and they were not concerned by the late submissions. The only stipulation at the time was that SAEDF would not be permitted to draw any funds down if the returns were not up to date.

1.18 Bank reconciliations prior to 1997

Management Comment:

The SAEDF accounting system was maintained by an accounting firm prior to Oct 1, 1997. A Chief Financial Officer was appointed near the end of this period, but left SAEDF. In January 1998 a new Chief Financial Officer was appointed and then in March 1998 the Financial Manager and Accountant were appointed. Reconciliations and records comprised 1 cardboard box and were hopelessly inadequate. From March 1998 the full time department had to reconstruct the department, reports, reconciliations, etc. It was for the same reasons mentioned by the auditors that prompted SAEDF management and board to appoint the full time department. Bank recons could not be located. If located they would not have been approved by a Financial Manager or Accountant as none of these positions existed.

Management agrees with the auditor's causes.

Management agrees with the recommendation. Since the introduction of a full-time Finance and Accounting department the processes did improve. For the period prior to this, it is agreed that most documents are missing and it is difficult to determine if bank recons were completed. Management will strive to continuously improve controls in this area.

1.19 Bank reconciliations 1998 – 2003

Management Comment:

Bank reconciliations were performed monthly. The reconciliations were performed by the Accountant and reviewed by the Financial Manager. Periodically the Chief Financial Officer used to randomly sample/review the reconciliations. At month-end a "Bank reconciliation" checklist detailing all the bank account was initialled by the Accountant. The Financial Manager would then review the bank recons and sign the "Monthly Control Checklist". The Chief Financial Officer reviewed the checklist every month, and copies of the signed checklists were attached to the monthly Management as well as quarterly Treasurer's reports for review by the rest of SAEDF management (Monthly and Treasurer's reports) and the SAEDF board (Treasurer's Report only). A review of the SAEDF bank reconciliations showed that the above procedures were adhered to for a vast majority of the period in question.

The bank reconciliations were never reviewed by the Chief Executive Officer. However the Chief Financial Officer reviewed the reconciliations on a periodic basis.

Management agrees with the auditor's causes.

Management agrees with the recommendations and will strive to continuously improve controls in this area. Management, however, do not feel that it is necessary for the Chief Executive Officer and Chief Financial Officer to review bank reconciliations. Once the Chief Financial Officer is appointed he will periodically review the bank reconciliations performed by the Accountant (and primarily reviewed by the Financial Manager).

1.20 Unreasonable costs

Management Comment:

Telephone expenses, while travelling, were charged to the hotel room and therefore to contract of employment and it was therefore unnecessary to repeat them in the appraisal form. Individual ratings were given but the percentages and numbers differed between departments.

Management agrees with condition 1.c. The updated HR policy, currently being completed, will rectify these issues.

Management agrees with the auditor's cause.

It is agreed that the formats were not standardized in the early years. However in 2002, after the initial McKinsey report, a standardized appraisal process was adopted. Staff strengths, weaknesses, deliverables etc were all detailed in the appraisal form. The updated HR policy, currently being completed, will rectify these issues.

1.17 Authorisation of expenditure

Management Comment:

The reason for an independent person reviewing the invoice was to prevent the possibility of fraud. However, with the introduction of the Procurement Manual this risk was eliminated as the originator approved the purchase requisition, the Chief Financial Officer/Financial Manager approved the purchase order and then the originator approved the invoice. It was SAEDF's view that as the originator was responsible for his own budget he should also be required to approve the invoice. By approving the invoice the originator checked the goods/service and his approval was acceptance that the goods/service was acceptable.

Accpac accounts payable module has a feature that prohibits the capturing of an invoice more than once. In addition, SAEDF policy was to only pay original invoices. In the event that an original invoice could not be found and SAEDFs accounts payable reconciliation confirmed that the invoice was outstanding then the payment was made. It is understandable that copy documentation was attached to expense claims as all originals were attached to the credit card statements (where payment was made by SAEDF credit card). Again, this is an example of the auditors misunderstanding of the processes involved. For travel reimbursements SAEDF used a spreadsheet that monitored the expenses for each business trip as well as the reimbursements. In later years it does, however, appear that this spreadsheet was not utilised and the possibility for reimbursing an employee more than once could occur. In future SAEDF will stamp the documentation "paid" to avoid duplication.

Credit card policy was that documentation was attached to the original credit card statements (Finance and Accounting allocated the copy statement for capture into Accpac). The original statement was then signed by the cardholder and reviewed by the department head. The missing credit card documentation was a result of misfiled credit card statements and documentation by the recent Finance and Accounting staff. Files were reconstructed without fully understanding the existing filing system, resulting in documents being misplaced or misfiled.

The auditor's cause is incorrect. However management does agree that the procedure needs to be reviewed and updated.

Management agrees with the recommendation. In addition management feel that the procurement process controls need to be enforced and updated.

Finance and Accounting and legal departments. The primary cause was the lack of understanding of the South African labour law and therefore a lack of understanding of the steps necessary to affect the terminations. Historically the Finance and Accounting department were informed of the termination decisions after-the-fact and were informed of the *month's salary to pay on termination.*

Condition 2 is incorrect. All terminations prior to 2003 had detailed workings of the termination amounts and were kept in the payroll files as well as in the Financial Manager's database. The costs were allocated to the salaries expense account as the amounts were paid via the payroll system, after deduction of taxes.

The SAEDF board appointed a temporary Chief Executive Officer to administer the Fund. The Interim Chief Executive Officer was given the authority to determine the staffing requirements of the Fund. He therefore decided that the SAEDF investment department needed restructuring and therefore effected the terminations.

Management agrees with the auditor's causes.

Management agrees with the recommendation.

1.15 Annual financial statements

Management Comment:
Management agrees with condition 1 and 2. The 2002 and 2003 annual external audits were stopped as a result of the US Regional Inspector General disqualifying SAEDF's external auditor from the list of USAID-approved auditors.

SAEDF management always finished the annual financials before the due date. For most years the delays in finalizing the annual financial statements were due to the following:

- Disagreement on the investment valuations,
- Finalisation of the audit report to management,
- Approval from the US branch of the external auditor with respect to compliance with US GAAP.

Management agrees and will attempt to finalise the AFS prior to January 31, but as the process has been delayed by the auditors /USIG audit it will take a while to complete.

1.16 Performance management

Management Comment:
Appraisals were performed during these years and were signed by the appraiser and the appraised. Original Finance and Accounting appraisal forms were filed in the SAEDF safe as they contained confidential information. At no time during the auditors audit were SAEDF staff requested to provide these appraisals. SAEDF staff were appraised on performance for the past 6 months.

The appraiser would identify areas that required improvement and communicate the facts to the appraised. The appraised would then be required to identify training courses that would assist in development in these areas. In the next appraisal the appraiser would again review these areas. Staff responsibilities were *detailed in their job descriptions and* the correct expense account. Certain operational expenses are payable in advance. When paid the payment is allocated, via the Accpac system, to the prepayments account in the balance sheet. Journals are then passed each month releasing a portion of the payment, as per the matching principle in accounting, to the expense account in the income statement. The auditors did not understand the process and therefore could not trace the documentation/payment.

The auditors had difficulty reconciling the amounts listed on the expense claim forms (multi-currency) and the figures in the general ledger (US$). The sum total of the expense item on the hotel bill divided by the exchange rate will equal the expense claim amount. On a few occasions the auditors used the incorrect exchange rate to trace the expense to the general ledger. The rates used for expense claim and advances are shown on the face of the claim form. This policy meant that SAEDF would contra the advance against the credit shown on the claim form, thereby eliminating the need for journals to correct minor exchange differences. The missing credit card documentation was a result of misfiled credit card statements and documentation by the recent Finance and Accounting staff. Files were reconstructed without fully understanding the existing filing system resulting in documents being misplaced or misfiled.

Management agrees with condition 2.d. The allocation of expenses to the correct expense account was due to management's desire to present accurate financials. These re-allocations were usually a result of the Chief Financial Officer disagreeing with the FM on a particular allocation.

Management agrees with condition 2.e. Cheques were previously filed together with the cheque requisition. SAEDF is currently re-filing the cheques into separate files. Note: Even though the cheques were attached to the requisition a register was completed each month, and filed in the front of the cheque requisition file, indicating whether or not the cheque had been returned.

The auditors did not understand the petty cash process. All receipts/vouchers/invoices were attached to the voucher in a separate "petty cash" file. Only the reconciliation was attached to the cheque requisition. On reimbursing the petty cash the cash on hand was counted by the Financial Manager and the petty cash officer. On receipt the same 2 people counted the cash. A receipt was signed and left in the receipt book.

The auditor's causes are incorrect.

All Finance and Accounting files were retrieved from Metrofile. SAEDF will review all files at Metrofile and compile a checklist to account for future file movements.

Management agrees that it must maintain its records in terms of their policies and procedures.

SAEDF has managed to trace virtually all of the amounts that comprise the charge by understanding the processes mentioned above. The amounts are therefore allowable.

1.14 Employee termination costs

Management comment:
Management agrees with condition 1. Historically staff terminations have been on the instruction of the Chief Executive Officer, without adequate consultation with the SAEDF

Condition 1.a is incorrect. All reference numbers relate to a specific document. If the reference is a "CB" it indicates that the item is a cashbook entry – usually a cheque or bank transfer reference number. If the reference is a "AP" it refers to an accounts payable entry and the reference number is a supplier invoice number. The only difference would be American Express, where invoice numbers could not be used, as SAEDF never received all backing invoices attached to the monthly statement. SAEDF had to allocate the payment directly from the Amex statement. Similarly "AR" related to accounts receivable and was a SAEDF generated invoice (usually to an investee for a debt payment). the auditors did not realise that there are a few SAEDF cashbooks/bank accounts. The general ledger reference for cashbook "04" is the Wachovia check account. SAEDF quickly found the cheque requisition, cheque and copy documentation are in the Wachovia cheque requisition file. It appears that the auditors searched the "10" cashbook files, which was the Nedbank cheque account in South Africa. On a number of occasions the auditors stated that documents were untraceable. On investigation SAEDF discovered that the reference that the auditors stated was a cheque number was in fact an invoice number. A simple trace of the invoice, via the Accpac accounts payable module, led to the original invoice and Personal payment. The auditors also mistook bank transfer reference numbers for payment references, and therefore could not trace the amount to source documents.

Condition 1.d is incorrect. Partly due to the problems mentioned above and partly due to SAEDF Finance and Accounting staff not being able to trace the references themselves. However with an understanding of the use of references (as above) and with sufficient knowledge of Accpac the transactions can easily be traced. SAEDF has all Accpac general ledger databases on the SAEDF network and the accounts payable modules for most years. By simply accessing "enquiries" and "vendor transactions" one can trace invoice numbers as well as the matching payment.

Regarding the lack of supporting documentation (condition 2):

Condition 2.a is incorrect. All of the Accpac sub-modules post into the general ledger, and then the general ledger retrieves the information. In other words all the supporting documentation for accounts payable will be attached to the payment. The only entries that are manually captured into the general ledger are journal entries. Journals are filed in separate files, with accompanying documentation. When batches are retrieved in all modules they must first be printed before they can be posted. In this way there is always a printed copy of every transaction posted to the general ledger. On review it appears that some of the Accpac printouts have been misfiled and other missing altogether. Even though these batches cannot be re-printed the information can still be viewed in the Accpac database.

The auditors did not understand the process of correcting journal entries. Essentially this was allocating an entry from one account into another. No documentation was attached to the journal as it would be attached to the original payment, and it would be pointless to copy every document. The payment and invoice are traceable through the reference number given on the journal entry (via the cashbook or accounts payable). Similarly, the auditors did not understand the workings of the suspense account. Expenses that cannot immediately be allocated to a particular account are allocated to the suspense account. Once the true nature of the expense is known the amount is reversed out of the suspense account into

1.11 Unreasonable/excessive travel expenditure

Management Comment:
The Chief Executive Officer was of the opinion that he needed his Personal Assistant to accompany him to plan the board meeting, arrange board meals, take minutes etc. It was his view that it was not unusual for a Chief Executive Officer to take an assistant on trips.

At the time the Chief Executive Officer's Personal Assistant booked board travel. It was her opinion that all senior managers should not travel on the same flight, due to the key man risk. However, it was incorrect for SAEDF to pay for the expenses while in London.

Movies were classified as personal expenditure and were therefore deducted from the M&IE allowance paid to the employee. If the expenditure in question was not deducted from the M&IE per diem then it was an error. USAID approved that SAEDF could incur expenditure on alcohol for business-related meals. The amounts were to be deducted from non-grant income.

The auditor's claim of 33 no-show rooms for the Westcliff Hotel is incorrect. In fact only 2 rooms were available of which 1 was taken by the Chief Executive Officer's Personal Assistant. This was agreed upon, as she was unhappy about travelling home alone at night.

The auditor's cause is incorrect.

SAEDF agrees that it must comply with applicable OMB requirements. SAEDF could not comment on the $110,334 amount as the auditors, after numerous requests, failed to provide the workings and composition of the amounts in question.

The US$110,334 either did not appear in the progress reports or the KPMG-provided reference number was incorrect. The auditors failed to provide SAEDF, after repeated requests, with the working papers for this amount.

1.12 Unallowable expenditure

Management Comment:
USAID approved that SAEDF could incur expenditure on alcohol for business-related meals. The amounts were to be deducted from non-grant income.

The auditor's cause is incorrect.

SAEDF needs to allocate all such expenditure to a separate account so that it can be deducted from non-grant income. Management will perform the reconciliation and prepare a journal entry correcting the error.

Management agrees with recommendation 2.

1.13 Anadequate documentation and audit trail

Management Comment:
It is unclear what misallocations the auditor is talking about.

However, this did occur on a couple of occasions due to errors or financial predicaments. In all cases the staff members paid the amounts back to SAEDF. SAEDF policy with regard to travel of board members was that an indirect airfare was allowed if the cost of that ticket was less than the cost of a direct flight from his home town/city. If board members stopped off somewhere on the way to a SAEDF board meeting the accommodation expense was paid by the board member, not SAEDF. On review of the invoice it appears that the cost of the airfare was less than or equal to the cost of a direct flight from Atlanta to Johannesburg. It is SAEDF's view that this amount is allowable. In the second instance SAEDF did not pay the accommodation costs for its legal counsel for 3 days in Cape Town. The charge stated that he was not in Cape Town on SAEDF business and SAEDF should not have paid. On review of the invoice and statement no evidence could be found that the expense was paid by SAEDF (the invoice only indicates that the airfare was charged to SAEDF). It was noted that the invoice was also an itinerary, and for this reason displayed the accommodation details. It was also noted that most of the US-based directors flew to Cape Town, stayed overnight, and then flew to the US. This is allowable as the South Africa to Atlanta flight can only fly directly to Atlanta at certain times during the year. The costs of the 2 flight routes are identical.

The auditor's cause is incorrect (as above).

SAEDF board expenses were monitored via the monthly and quarterly management reports and presented to the SAEDF board. The costs were usually high due to the distances, and resultant airfare costs, involved in travelling to the meetings. As the board members are not paid to sit on the SAEDF board the charges do not appear excessive. In future SAEDF management will make sure the chosen hotel accommodation complies with the USAID per diem allowances.

Management feel that the procedures adopted above are satisfactory and do not reduce the level of financial control. Therefore the expenditure is allowable.

1.10 Officers and employees expenses

Management Comment:

It is unclear what the auditors are charging management with. Per diems were allowed for lodging and for meals and incidentals. As accommodation was pre-booked and paid via the SAEDF credit card no lodging per diem was given. On approval of the travel form the travel request had to comply with the lodging per diem rates, and to managements knowledge did. Staff would then receive an M&IE per diem advance to cover expenses such as meals and other incidentals. Any personal expenditure was then netted off this advance when the employee submitted his claim form on his return.

All reimbursements were required to have backing documentation. On very few occasions vouchers/invoices were missing. However in these cases, the employee in question had to request copy vouchers/invoices. Failure to do so would result in the employee having to justify the expenditure (via memo) to the Chief Financial Officer and his department head. Failure to do this resulted in the questioned amounts not being refunded to the employee.

The auditor's cause is incorrect.

Some of the documentation appears to have been misplaced and is therefore impossible to verify at this stage. However, SAEDF was able to recover a large portion of the disputed amounts via the Accpac accounts payable module. SAEDF is busy reviewing the Finance and Accounting files and will not encounter these problems again.

these reports that the Chief Financial Officer and Chief Executive Officer never approved the trip would have been queried during their management meetings.

It is unclear which trips an employee on the same level as the traveller approved. It is possible that one Vice President approved the travel of another Vice President. In these instances they would have done so in line with their authorisation limits.

SAEDF credit card policy did not require senior investment managers to approve statements. The person who used the card signed the statement as acceptance of the itemized expenses. The senior manager would then review the statement, vouchers and charges. It is accepted that the manager should have been required to sign the statement to reflect his approval.

The auditor's cause is incorrect.

SAEDF regards their travel policies as satisfactory. However, the additions to the existing policies that SAEDF adopted informally should have been formally incorporated into the policies and procedures manual (instead of via e-mail or internal memorandum).

Management feel that the procedures adopted above are satisfactory and do not reduce the level of financial control. Therefore the expenditure is allowable.

1.9 Board member's expenses

Management Comment:

Vouchers for board member reimbursements were attached to all payments. In the majority of instances the auditors reviewed documents in the incorrect cashbook. In other words they reviewed documents attached to the local bank cheque number, when the payment was made via SAEDF's US-based bank.

When credit card statements arrived from Nedbank copies were made for Finance and Accounting and the originals were handed to the cardholders. The cardholder attached all vouchers to the original statement and identified all business or personal expenditure. The cardholder signed the statement verifying the correctness of the information. Finance and Accounting would then allocate the expenditure on the copy statements. Any unreturned original statements would be immediately evident. Statements were firstly reviewed by the department head, and then by Finance and Accounting. Any questionable expenditure was queried with the department head. It is agreed that department head approval was not evident and should have been enforced. The American Express card was a SAEDF "lodge" card. This meant that the card was held by SAEDF's travel agent and was used to book airfares and hotel accommodation. No approval will be evident on the Amex statement as the approval was signed via the purchase requisition, prior to purchase. In 1998, the newly created Finance and Accounting department found the Diners Club credit cards as well as SAEDF's lack of credit card policies at the time insufficient, and the cards were cancelled. New Nedbank credit cards were handed to staff after signing the newly generated credit card policy document.

The Chief Executive Officer and Chief Financial Officer were only required to check/approve the statements for staff in their own department or for one another, not for all staff. The Chief Financial Officer and department heads reviewed the statements. Management agrees that the senior manager should sign the statements as proof of review and acceptance.

SAEDF staff were not permitted to use the SAEDF credit cards for personal expenses.

satisfactory and do not reduce the level of financial control.

Management agrees that policies and procedures should be adhered to.

Management believes that the idea of a contract committee is impractical for such a small organization and the task can form part of an employee's job title. Management will also update the Policies and Procedures Manual in order to reflect these changes, and to allow management to use a single supplier (without going through the tender process for each purchase) if certain steps are followed. In this way the bureaucracy will be reduced and staff can concentrate on their primary job functions.

Management feel that the procedures adopted above are satisfactory and do not reduce the level of financial control. Therefore the expenditure is allowable.

1.7 Conflict of interest

Management Comment:
The SAEDF board decided that as the SAEDF director in question was only a shareholder in the parent company, Adcorp Holdings Ltd, that there was no conflict of interest (SAEDF board responses to KPMG Internal Audit 2003). Management no longer uses the recruiting company and agrees that the percentages paid were high.

SAEDF has since engaged the services of one of South Africa's premier forensic investigation companies to look into these charges.

Management agrees with condition 3. The director gave full verbal disclosure of her interest in the transaction. The board instructed the Chief Executive Officer to obtain the written disclosure, which he failed to do. His services were terminated, in part, as a result of this transaction.

Management agrees with condition 4. The director gave full verbal disclosure of her interest in the transaction. The board instructed the Chief Executive Officer to obtain the written disclosure, which he failed to do. His services were terminated, in part, as a result of this transaction.

The auditor's cause is incorrect.

Management agrees with the recommendation.

1.8 Travel and Accommodation

Management Comment:
Management agrees with condition 1. However it is incorrect to state that the system improved in recent years, as it appears that recently some travel authorization files have been misplaced or misfiled. SAEDF is in the process of reconstructing the files to their former state so that quick referencing to travel documentation will be possible.

In very few instances investment staff were required to travel without notice. The trip was verbally approved by the Vice President/Senior Vice President and when the Personal Assistant had the opportunity to complete the form it was done and signed. It must be mentioned that it was not possible to "hide" these trips as senior management received a detailed monthly report (Accpac-generated reports as well as the Internal Management Report) showing the trips taken during the period. Had a trip appeared in

The auditor's cause is incorrect (see above responses).

Management agrees with the recommendation.

1.6 Procurement process

Management Comment:
Historically quotes were obtained, according to the policy, for all purchases (excluding legal). However, the quotes were usually filed in a separate file by the Office Manager and therefore are not evident to the auditors. SAEDF will correct the system to make sure that quotes are attached to the requisition/order.

McKinsey were appointed in 2000/1 to perform the SAEDF mid-course review. As SAEDF was established in 1994/5 the mid-course review had to be performed at that time (5th year of the proposed 10 years). The approval can be found in the minutes of the executive session of the March 2000 board minutes.

In response to condition 2, management has since settled all outstanding amounts with McKinsey.

The former SAEDF Chief Executive Officer approved the expenditure in order to help promote SAEDF's image in the region. It is understood, as they involve self-promotion, that these expenses cannot be paid out of Grant funds, but can be paid from "Reflow" funds. The expense was correctly allocated to the "suspense" account in the balance sheet. This account kept track of all expenditure that did not comply with OMB requirements. In September 2002 the Finance and Accounting department incorrectly re-allocated the expense to the "promotions" account in the SAEDF income statement.

Management agrees that the tender process for the SAR consultant was not followed. SAEDF staff attempted to identify a consultant to perform the function, without any success. The Chief Executive Officer at the time knew of the consultant and approached her to provide SAEDF with a quotation. On receipt of the quotation SAEDF queried the reasonableness of the amount with the Chief Executive Officer, who confirmed that the amount was within the parameters for the required work. As Chief Executive Officer he then took the decision, as it was within his authorization limit, to approve the contract. SAEDF was satisfied with the work compiled and to management's knowledge so was USAID. SAEDF decided to replace the Contract Committee with the Office Manager. At the time the size of the organization as well as the low number of monthly vendor transactions made the Contract Committee impractical. Management at the time decided that the tasks of the committee would be better handled by the Office Manager.

The supplier selection process was not formalized and was left as the responsibility of the Office Manager. Management also instructed the Office Manager to use vendors owned by previously disadvantaged citizens (BEE). It was managements view that SAEDF's mission was also to help these companies "get off the ground" and would therefore give them a higher "weighting" in the tender process.

If any staff member was unhappy with the service offered by the vendor the Office Manager would approach them or change to another supplier. As most of the selection process was verbal, it is accepted that the process should be more formalized.

Cause 1 is incorrect (see above responses).

Management agrees with cause 2, but feel that the procedures adopted above are

Officer's son. This amount formed part of the SAEDF counter-claim in the lawsuit.

Management agrees with condition 2.

All of the above allowances received board approval and therefore are allowable.

1.4 Bonuses

Management Comment:
After conducting the appraisal process SAEDF bonus proposals are forwarded by the various department heads to the Chief Executive Officer for approval. The Chief Executive Officer, in consultation with the other department, heads agrees/disagrees with the recommended percentages/amounts. The final management authority on these amounts/percentages is the Chief Executive Officer, who then presents all SAEDF salary increases and bonuses to the SAEDF board Personnel Committee. Although the Chief Executive Officer had the final authority in the process the process was deemed acceptable by SAEDF management and board. Staff who felt that their bonuses/increases were unacceptable were free to discuss the issue with the Chief Executive Officer.

The auditor's cause is incorrect. Although the Chief Executive Officer had the final authority, his decision was influenced by the recommendations of the department heads.

Bonuses are presented to the SAEDF board Personnel Committee on an annual basis for review, along with the salary increase recommendations. The amounts were approved by the committee and are therefore allowable.

1.5 Lack of completion of purchase orders

Management Comment:
On review of the files it appears that the relevant purchase requisitions and orders had been detached from the cheque requisition/bank transfer and filed in a separate file. Management agrees that in the 2003 financial year the use of requisitions and orders was not enforced. In addition the budget control sheets, which determine if the budget will be exceeded prior to disbursement, were not utilized at all.

It is SAEDF policy that all requisitions be approved by a senior official/head of department. However, it is possible that the auditors reviewed the purchase orders, not the purchase requisitions. On review of the Procurement Manual it is clear that the purchase requisition is the document that approves the purchase, not the purchase order. The contention that the purchases made might not have been valid is incorrect as the person who approved the invoice for payment was different from the person who prepared the order. As additional checks the Chief Financial Officer/Financial Manager approves all payments and would have noticed any unapproved expenditure.

Purchase order dates were occasionally after the invoice date due to the non-compliance with the policy by the staff preparing the purchase requisition or order. To trace the staff member who had failed to follow the procedure each department Personal Assistant was given a sequentially numbered requisition and order books. Non-adherence to the policies could be traced via the requisition/order number and the offending Personal Assistant was reprimanded. The fault in the process was that the heads of these departments failed to insist on compliance with the policies (and were sometimes the offenders) and therefore undermined the process.

Condition b is incorrect. For the years 1998 to 2002 (and part of 2003) formal employee appraisals were held annually in August. The employee was appraised by his/her department head and then the department head would review the employee's appraisal with the Chief Executive Officer. If there was any disagreement between the department head and the Chief Executive Officer the increase/bonus would reflect the Chief Executive Officer's position. It is agreed that the system should not have relied so heavily on the Chief Executive Officer's opinion/attitude towards the employee/s. In recent times employee performance, and therefore appraisals, have been affected by the sequence of audits the company has undergone. For this reason the original performance targets could not be the sole evaluation item as the majority of the staff were involved in the audits.

It appears that the reasons given by the Chief Executive Officer to the SAEDF board for the increase were not accurate. The increase percentage agreed by the board did not agree with the figure given by the Chief Executive Officer and was queried by Finance and Accounting. The issue in question was communicated by SAEDF to the Audit Committee chairperson and eventually led to the investigation of the Chief Executive Officer and his eventual removal from position.

Management agrees with condition b.2. The then Chief Financial Officer forwarded an approved (by him) increase proposal to the Chief Executive Officer. The payroll was adjusted and the increase paid. However, on questioning this, and other issues, the Chief Financial Officer departed SAEDF. On review of work performance it was agreed that the increase was excessive.

Management agrees with the recommendation.

1.3 CEO benefits

Management Comment:

Condition 1.a is incorrect. The SAEDF board approved a US$1,200 per month motor vehicle allowance for the Chief Executive Officer. The Chief Executive Officer did not receive the "free" use of a company car and a motor vehicle allowance. The vehicle allowance was included as income in his monthly salary and therefore was subject to FICA taxation (USA). In turn, SAEDF leased a vehicle for the Chief Executive Officer's use. The monthly lease, petrol and satellite surveillance charges were then allocated against the allowance. Initially the allowance was the US$ equivalent of the ZAR lease charge for the vehicle. However, in later years the devaluation of the ZAR resulted in the $1,200 allowance (in ZAR terms) exceeded the lease charge (in ZAR) leaving a credit balance in the expense account.

Condition 1.b is incorrect. The board approved a US$4,000 per month housing allowance for the Chief Executive Officer. At the time the ZAR equivalent (+-ZAR 18,000) was deemed reasonable for the level of residential housing approved for the Chief Executive Officer. In later years the devaluation of the ZAR increased the figure in ZAR-terms. As SAEDF is a US entity, and the Chief Executive Officer's salary paid in US$ in the United States (excl. allowances) it is irrelevant what effect the currency had on the allowance.

According to the Chief Operating Officer's contract he was entitled to US$33,000 a year to cover school costs for his children. The allowance was carried over to his term as Chief Executive Officer. It was unclear whether the year was a calendar year, SAEDF financial year or year from recruitment. The Chairman then decided, due to the urgency of the matter, to approve the additional US$13,738 (e-mail attached to bank transfer). It was decided that the costs would be averaged over the SAEDF financial years. The US$10,116 was unallowable as it related to the university costs for the Chief Executive

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Appendix 3 – Summary of findings

1. COMPLIANCE WITH AGREEMENTS, LAWS and REGULATIONS

1.1 Timekeeping

Management response:
Condition 1 is incorrect. The SAEDF payroll worksheets, which the auditors appear to have based their charges on, are not signed or approved. SAEDF Finance and Accounting ("Finance and Accounting") department uses Monthly Control Checklists to sign off the main monthly accounting procedures (including payroll). Once the payroll has been prepared the following are reconciled: expense accounts, salary control accounts and net payroll disbursements to the SAEDF bank statements. The Chief Financial Officer reviews and signs these reconciliations and the checklist when complete. SAEDF regards this as sufficient approval, but will implement Chief Financial Officer/Chief Executive Officer signing off the payroll runs prior to forwarding them to the service providers.

Management agrees with condition 2. However, it was decided that the same purpose would be served via the enforcement of the Human Resources Policy, especially via the use of leave forms. It is not practical to stipulate what each employee is doing for each day of the week/month/year, and if staff were not occupied with SAEDF work it would have been apparent to their manager, who would have rectified the problem. In addition the SAEDF board (including USAID) approved the SAEDF Human Resources Manual. As per OMB Circular A-122 SAEDF can use an alternative method to account for staff activity, as long as it has the approval of USAID. The approval of the HR Manual, effectively, is therefore this approval.

Condition 3 is incorrect. Staff attendance was, and still is, monitored via leave schedules. The leave days owed to staff were displayed on their monthly payslips. Staff were required to submit leave schedules with prior approval from their manager. Excessive leave days taken, contrary to labour legislation, were deducted from staff pay. However, the system was always ultimately reliant on staff honesty and there was a possibility of manipulation when staff were travelling frequently. For this reason it was possible that some staff may have taken leave without approval.

The auditor's causes are incorrect. Management is aware of the requirements of OMB Circular A-133 and feel that they have taken the necessary steps to comply.

Management feel that sufficient steps were taken to control, review and monitor timekeeping. SAEDF also took care to report any deviations from budget to the board (including USAID) via quarterly management reports. Salaries were also presented to the SAEDF board personnel committee on an annual basis for review, along with the bonus and increase recommendations.

1.2 Salary increases – Reasonableness

Management Comment:
Salaries are presented to the SAEDF board Personnel Committee on an annual basis for review, along with the bonus and increase recommendations. The minutes of these meetings will indicate that the salaries were reviewed and the increases approved.

2.13 Monitoring of investment ***Management Comment:*** See investment responses
2.14 Investment limits ***Management Comment:*** See investment responses

randomly sample/review the recons. At month-end the Bank Reconciliation checklist, and a Monthly Control Checklist, were initialled by the Accountant. The Financial Manager would then review the bank recons and sign the Monthly Control Checklist. The signed Monthly Control Checklist was attached to the monthly Internal Management Report or the quarterly Treasurer's Reports for review by the rest of SAEDF management (Monthly and Treasurer's Reports) and the SAEDF board (Treasurer's Report only). A review of the SAEDF bank reconciliations showed that the above procedures were adhered to for a vast majority of the period in question.

The bank reconciliations were never reviewed by the Chief Executive Officer. Only the Chief Financial Officer reviewed the recons (on a periodic basis).

A historical schedule of monthly checklists and bank reconciliations shows that management complied with the processes almost all of the time, but the maintenance of records was lacking.

Management agrees that bank recons should be safeguarded and steps will be taken to ensure this.

Management does not feel that it is necessary for the Chief Executive Officer and Chief Financial Officer to review bank recons. Once the Chief Financial Officer is appointed he will periodically review the bank recons performed by the Accountant (and primarily reviewed by the Financial Manager).

2.10 Conflict of interest

Management Comment:
Management agrees. The director gave full verbal disclosure of her interest in the transaction. The board instructed the Chief Executive Officer to obtain the written disclosure, which he failed to do. His services were terminated, in part, as a result of this transaction.

The auditor's cause is therefore incorrect.

Management agrees with the recommendation. However, these policies are already in place for directors and staff. The case in question was a result of the Chief Executive Officer not complying with board instructions, not a lack of a formal policy.

2.11 Maintenance of records

Management Comment:
See investment responses.

2.12 Due diligence process

Management Comment:
See investment responses

The procedure was that staff attached all vouchers to the original credit card statement, while Finance and Accounting allocated the expenses on the copy statement. On review it was discovered that the files have been altered and many signed credit card statements (originals) have either been misplaced or misfiled. The approval of credit card statements was a constant problem due to the lack of assistance Finance and Accounting received from the other SAEDF department heads. SAEDF contends that the policy was satisfactory, but adherence was not what it should have been. SAEDF is currently reviewing the filing and controls relating the credit card transactions.

All staff were required to physically identify business and personal expenses on their credit card statements as well as on vouchers. SAEDF policy at the time was to allocate all expenses on the copy statements and attach all vouchers to the original statements. The original statements were then signed by the employee and reviewed by the department head. It appears that the misfiling of these statements/documents is a result of recent SAEDF staff not understanding the process and therefore incorrectly altering the filing system. Although SAEDF feels the figure is well below the 75% mentioned by the auditors Finance and Accounting is currently reviewing the filing and controls relating the credit card transactions.

As a rule, SAEDF did not make payments on copy tax invoices. However, if an invoice was misplaced SAEDF would reconcile the creditor account to confirm that the payment had not been processed before. If the payment was urgent and an original tax invoice was to be posted on payment then the payment was filed in the "payments awaiting original invoices" file. This file was reviewed every time payments were made.

Purchase order dates were occasionally after the invoice date due to the non-compliance with the policy by the staff preparing the purchase requisition or order. To trace the staff member who had failed to follow the procedure each department Personal Assistant was given a sequentially numbered requisition and order books. Non-adherence to the policies could be traced via the requisition/order number and the offending Personal Assistant was reprimanded. The fault in the process was that the heads of these departments failed to insist on compliance with the policies (and were sometimes the offenders) and therefore undermined the process.

Management contends that the policies are satisfactory, but as with any system of control it is ultimately reliant on the staff in the process. Resistance of the staff to the process was a direct result of the failure of SAEDF's other (non Finance and Accounting) senior managers to enforce the process in their own departments. However, the failure to adhere to the policies was an exception, rather than the rule.

Management agrees with the recommendation, and feels that the policies should be formally reviewed and updated. Once complete the SAEDF board and USAID approval will be obtained. Of considerable confusion is that the updated Policies and Procedures manual was presented to the SAEDF board (incl. USAID) in 2001 and according to SAEDF management's understanding was approved. However, it appears that the approval was either not granted or not recorded. Had the document been approved it would have eliminated a large portion of the misunderstandings created in the audit.

2.9 Bank reconciliations: 1998-2003

Management Comment:

Bank reconciliations were performed monthly. The recons were performed by the accountant and reviewed by the Financial Manager. The Chief Financial Officer used to disbursement and is incorrect to state that there were none found.

Incorrect. On review it appears that the relevant purchase requisitions and orders had been detached from the cheque requisition/bank transfer and filed in a separate file. Management agrees that in the 2003 financial year the use of requisitions and orders was not enforced. In addition the budget control sheets, which determine if the budget will be exceeded prior to disbursement, were not utilized at all.

Accpac accounts payable has a feature that prevents an invoice number from being entered more than once. Monthly accounts payable reconciliations (Accpac to creditor statement) were performed, and reviewed. A further safeguard was that SAEDF did not make payments on copy tax invoices. If an invoice was misplaced SAEDF would reconcile the account to confirm that the payment had not been processed before. In the case of non-accounts payable payments Finance and Accounting would review the cheque and bank transfer registers to confirm that no prior payment had been made. To SAEDF's record only 1 duplicate payment occurred in the entire 6 year period and it occurred before SAEDF had a full-time accounting department and a fully functioning Accpac accounting system. Extensive controls have been implemented since this time.

SAEDF's policy requires that all purchase requisitions be approved by a senior official/head of department. Nevertheless it is possible that the auditors reviewed the purchase orders, not the purchase requisitions. The Procurement Manual identifies the purchase requisition as the document that approves the purchase, not the purchase order.

SAEDF complied with the approval limits. Should the auditors indicate the purchases where approvals were not adhered to SAEDF will in turn respond.

Quotations were either written in the space provided on the purchase requisition, or were attached to the purchase requisition. It appears that the purchase requisitions and orders have been detached from the payments, and therefore so have the quotes.

The supplier selection process was not formalized and was the responsibility of the Office Manager. If any staff member was unhappy with the service offered by the vendor the Office Manager would approach them to discuss the accusation or change to another supplier. As most of the selection process was verbal it is accepted that the process should be formalized.

SAEDF decided to replace the Contract Committee with the Office Manager. At the time the size of the organization as well as the low number of monthly vendor transactions made the Contract Committee impractical. Management at the time decided that the tasks of the Contract Committee would be better handled by the Office Manager.

The vendor tender process was adhered to, however SAEDF management instructed the Office Manager to use vendors owned by previously disadvantaged citizens (BEE). It was managements view that SAEDF's mission was also to help these companies "get off the ground" and would therefore give them a higher "weighting" in the tender process. In this way it is true that competition was reduced.

In the years 1998-2002 SAEDF did sign service contracts with certain vendors (excluding legal). The contracts were filed in the SAEDF "contracts file". If any staff member was unhappy with the service offered by the vendor the Office Manager would approach them to discuss the accusation or change to another supplier. When a service provider was used for a single assignment a copy of the contract was attached to the payment. SAEDF has since reviewed the file and certain documents were missing, while other documents have since been found.

1.30 *Frupac Limited (Zimbabwe) (Private) Limited ("Frupac")*

Maintenance of records

Criteria

Section 2.A of Enclosure 3 to the Agreement states; "The Grantee shall maintain books, records, documents, and other evidence in accordance with generally accepted accounting practice. The Grantee's financial management system shall: (i) provide for accurate, current, and complete disclosure for each Grantee-sponsored activity; (ii) identify adequately the source and application of funds for all Grantee-sponsored activities, and (iii) enable the Grantee to accurately determine Grant balances, book balances and reconciliation of book to Grant balances.[1]*

Condition

- There is no approved journal voucher and supporting documentation for the foreign exchange loss adjustment of $123,581 on the investment in 2002.

Cause

- Present SAEDF management were unable to give a reason for the condition.

Effect

In the absence of appropriate documentation, there is no evidence as to the authenticity of the accounting entry, and the foreign exchange loss of $123,581 is questioned as an unsupported cost

Recommendation

- The Contracting Officer should determine the allowability of $123,581 in unsupported questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

1.31 *Gili Greenworld ("Gili")*

1.31.1 Approval of investment

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures annual states that "the full board shall Ratify all investment decisions made by the CEO and the investment committee of the board".

Section E of Modification No. 06 to the Grant Agreement further requires that the application of the policies to individual investment decisions will be based on the business judgment of the Fund's board of directors *and* executive management '

Condition

The minutes of the SAEDF Board and investment committee of the board do not indicate that the investment committee of the board approved the investment of $1,916,783 in Gili or that the SAEDF board ratified the investment, i.e. management made the investment without the required approval.

Cause

- Present SAEDF management were unable to state the reason for the investment not being approved.

Effect

- The lack of approval for the investment results in the investment of $1,916,783 being ineligible and is therefore a questioned cost.

Recommendation

- The Contracting Officer should determine the allowability of $1,916,783 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

1.31.2 Investment limits

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[2]

Condition

SAEDF invested the following amounts in Gili:

15 February 2000 Disbursement $1,227,078

15 February 2000 Closing fee $12,286

7 August 2000 Disbursement $670,645

7 August 2000 Closing fee –$6,774

$ 1,916,783

This is in excess of the policy limits.

Cause'

Management believed that the limits as stated in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February ~~1999,~~ 1999. However, the increase was never formally approved by USAID.

Effect

m The investment of $1,916,783 is in contravention of the policies approved by USAID, and the amount in excess of $1,000,000 is therefore questioned.

Recommendation

- The Contracting Officer should determine the allowability of $916,783 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comments

[redacted]

[redacted]

[redacted]

[redacted]

[2] **In** the **absence of a** definition of "fund's value", and for the sake of practicality and a conservative approach we have **uniformly** applied the $ 1 million threshold as the investment limit in computing questioned costs.

L32 Khan & Partners ("K&P")/Integrated Pathology Services ("IPS")

Monitoring of investments

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the

Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits'* states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition'

- An investment of $437,072 was made in K&P but the investment in K&P was not appropriately monitored. There were no management accounts or quarterly reports in the monitoring files or other evidence of monitoring.

Cause

There is no formal SAEDF policy relating to monitoring. Investment staff did not monitor the investment after disbursement.

Effect

SAEDF were not able to detect the deterioration in K & P's operations and financial position.

Had SAEDF monitored the investment more vigorously, these could have been identified and SAEDF could have re-aligned its proposed position in K&P, or have had a more 63 hands-on approach in ensuring that the deficiencies were adequately addressed. Accordingly SAEDF may not have had to write-off its investment in K&P.

Recommendation

- The Contracting Officer should determine the allowability of $437,072 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

1.33 *Kagiso Ventures Private Equity Fund I ("Kagiso")*

1.33.1 Due diligence

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the abovementioned SAEDF Investment Policies, Guidelines and Procedures Manual requires that the due diligence process must be performed prior to approval and disbursement.

Condition

- There is no due diligence report supporting a due diligence review.

Cause

- Present SAEDF management were not able to state any reason for the absence of a due diligence report,

Effect

- An investment of $3,184,127 in Kagiso was made without the required due diligence report being made available and is thus questioned as an ineligible cost.

Recommendation

- The Contracting Officer should determine the allowability of $3,184,127 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

1.33.2 Investment limits

Criteria Paragraph C of Modification No. 06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[3]

Condition

SAEDF invested the following amounts in Kagiso for a 11,32% interest in the partnership:

12 Jan 2000	Disbursement	$	185,620
12 Jan 2000	Disbursement	$	234,466
31 Mar 2000	Re-imbursement	$	(74,410)
20 Mar 2000	Disbursement	$	558,749
26 July 2000	Disbursement	$	49,782
29 Jan 2001	.Disbursement	$	43,846
23 Aug 2001	Disbursement	$	502,564
31 Jan 2002	Disbursement	$	29,750
29 AiigiiXG	Disbursement	$	358,592
27 Jan 2(j<&	Disbursement	$	33,558
8Apr'2Q<>3 ;,	Disbursement	$	710,655
27 June 2S&3J ^	Disbursement	$	506,471
5 Aug 2003 " ,	Disbursement	_$	44,484
		$	3,184,127

This is in excess of the policy limits.

[3] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly **applied** the $1 million threshold as the investment limit in computing questioned costs.

Cause

Management believed that the limits, as set out in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect

- $2,184,127 of the investment of $3,184,127 was not properly authorised, this amount is therefore questioned as ineligible.

Recommendation

- The Contracting Officer should determine the allowability of $2,184,127 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

1.34 Kingdom Securities Holdings Limited ("KSHL")

134.1 Investment limits

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[4]

Condition

SAEDF invested an amount of $1,200,000 in the purchase of preference shares in KSHL.

This is in excess of the policy limits.

Cause

Management believed that the limits, as set out hi the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect

- The investment of $1,200,000 is in contravention of the policies, as approved by USAID, and the amount in excess of $1,000,000 is therefore questioned.

Recommendation

- The Contracting Officer should determine the allowability of $200,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

[4] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the SI million threshold as the investment limit in computing questioned costs.

1.34.2 Redemption of shares

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extend to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

Condition

SAEDF's Board of Directors approved an investment in KSHL. SAEDF management were under the impression that the preference shares would be redeemed in US$. During the redemption process it was, however, noticed that the Investment Agreement stated that the preference shares would be redeemed in Zimbabwean dollars (Z$) and not in US$. The Z$ was already deteriorating in value at the time of the investment.

An Internal Discussion Draft, dated February 9, 2000, prepared by Mr. Jesse J. Spikes (Long Aldridge & Norman - LAN) and addressed to a former CEO, suggests that the redemption price of the shares was incorrectly changed from US$ to Z$ during the process of drafting the agreement.

Cause

The investment associate succumbed to pressure from KSHL and, without proper authorization, changed the agreement in order to finalise the deal.

Effect

SAEDF suffered a loss of US$646,308 as a result of the foreign exchange difference on redemption of the investment.

Recommendation

- The Contracting Officer should determine the allowability of $646,308 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

L35 Liquefied Foods Limited ("LFL ")

Monitoring of investment

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but father would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition

SAEDF invested $1,180,000 in LFL. In the initial phase of this investment, the monitoring of funds disbursed Was poor with little follow up on the usage of the monies received by the investee from SAEDF. Furthermore, no decisive corrective action was taken for defaults or contraventions **of covenants** or loan agreement clauses identified by SAEDF investment associates.

Cause

Present SAEDF management were unable to state the reason for the poor monitoring or no action being taken.

Effect

SAEDF were not timeously aware of the risk to their investment and put it at further risk by not taking action when problems became known. Ultimately they wrote off the full investment in LFL.70

Recommendation

The Contracting Officer should determine the allowability of $1,180,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted].

1.36 *Megkon (Pty) Ltd/Autoster ("Megkon")*

136.1 Prohibited investments

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures 7 anual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 10 of the SAEDF Investment Policies, Guidelines and Procedures Manual states that the fund shall not invest in ventures or transactions involving defence - we interpret this to mean any transactions dealing with the armaments industry.

Condition

An investment of $5,267,036 was made in an industry involving defence.

In the initial due diligence report prepared by SAEDF investment associates in December 1999, it was noted that Megkon was initially set up as an engineering consulting company, providing services to the "armaments industry" which was subsequently crossed out and changed to "Corporate Market in South Africa".

Dr Piet Stokers, the Chairman and Managing Director, who established the company in 1982, was the leading aeronautical engineer responsible for the development of the "Rooivilk" -a military helicopter - for the South African National Defence Force (SANDF).

The minutes of a Megkon Board meeting held on March 1, 2001 details discussions regarding the various companies within the group. For the Consulting Services (CS) the comment madft^is that "Military consultation is profitable. We intend to remain in this market for as long as it makes a positive contribution to cash flow."

From the above it can be seen that SAEDF was involved in prohibited industries.

Cause

Present SAEDF management are unable to state why the provisions of the Grant Agreement were contravened.

Effect

SAEDF invested in a prohibited industry. Accordingly, the entire investment of $5,267,036 in Megkon is questioned as an ineligible cost.

Recommendation

The Contracting Officer should determine the allowability of $5,267,036 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

1.36.2 Investment limits

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[3] (This limitation refers to initial investments only and not additional funding).

Condition

SAEDF's initial investment in Megkon was $3,767,036, which exceeds the policy limits.

Cause

Management believed that the limits were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect

The investment of $3,767,036 was made in contravention of the Grant Agreement. The amount in excess of $1,000,000, i.e. $2,767,036 is therefore questioned as an ineligible cost

[5] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

Recommendation

The Contracting Officer should determine the allowability of $2,767,036 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

1.363 Monitoring of investment

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection"iC "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In **preparation** of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to "the fund by **investees**. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition

As per the September 2001 quarterly report, it was noted that:

The company was technically insolvent. Megkon had a negative net asset value due to the huge balance of $1.99m million relating to shareholder's loans, and

Liabilities exceeded Assets, which results in reckless trading.

A Discounted Cash Flow Valuation was performed, and reported as:

Valuation of Company (Alcar model)	$2,034,544
Valuation of SAEDF's Investment	$309,250

Even after the above financial issues and information, a further amount of $1,500,000 was granted and disbursed to Megkon Limited during October 2001. SAEDF decided to put Megkon into liquidation on June 7, 2002, a mere 9 months after the additional disbursement of funds to Megkon.

Cause

Present SAEDF management were unable to state the reason for the additional funding to Megkon in the light of its precarious financial situation.

Effect

SAEDF put their funds at un-necessary risk in disbursing further funds to Megkon and ultimately wrote off the additional $1,500,000.

Recommendation

The Contracting Officer should determine the allowability of $1,500,000 in ineligible questioned costs and recover from SAEPF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

1.37 Mozambique Equity Fund ("MEF")

Monitoring of Investments

Criteria

Section D.I of Enclosure 2 to the Grant Agreement states that "The Fund's primary activity will be to provide financial resources and services through the investment of risk capital in profitable opportunities throughout Southern Africa."

Paragraph G of Modification No. 06 to the Grant Agreements states that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling Of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare[1] pr-receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition

SAEDF invested $882,000 hi MEF. No quarterly reports were on file for the period January 2003 onwards, and there is no other evidence of monitoring after this date.

The December 2002 report indicated that the fund (MEF) had only made one investment of $180,000 up to that date. This means that from the date that SAEDF disbursed the funds of $882,000 on September 28, 2001, up to December 31, 2002, SAEDF's funds were earning interest to the advantage of MEF and not yielding any returns for SAEDF. It should further be noted that the $180,000 investment by MEF was also funded proportionately by the other investors in MEF. Even though only one investment had been made by MEF's management company, the latter still received monthly management fees, which were funded from the disbursements made to MEF by SAEDF. The effect of this is that the initial funds disbursed by the various investors were being exhausted through management fees and other expenses while no other investments were made.

Cause

SAEDF did not have a formal monitoring policy. Investment staff did not adequately monitor the investment in MEF.

Effect

SAEDF was not alert to the impairment to its investment in MEF through the way the latter was conducting its business. Ultimately the full investment of $882,000 was written off.

Recommendation

The Contracting Officer should determine the allowability of $882,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

7.38 *Metals Closure Group South Africa Limited ("MCG")*

1.38.1 **Approval of** investment

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that "the full board shall Ratify all investment decisions made by the CEO and the investment committee of the board".

Section E of Modification No. 06 to the Grant Agreement further requires that the application of the policies to individual investment decisions will be based on the business judgment of the Fund's board of directors *and* executive management.

Condition

SAEDF invested $2,159,036 in MCG. The minutes of the SAEDF Board and investment committee of the board, do not indicate that the investment committee of the board approved the investment in MCG or that the SAEDF board ratified the investment, i.e. management made the investment without the required approval.

Cause

Present SAEDF management are unable to state why the investment was not approved.

Effect

The lack of approval for the investment results in the investment of $2,159,036 being ineligible and is therefore a questioned cost.

Recommendation

The Contracting Officer should determine the allowability of $2,159,036 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

This investment was approved in September, 2001. See Appendix L1 for a copy of the board minutes containing the pertinent resolutions.

1.38.2 Investment limits

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less",[6]

Condition

SAEDF invested $2,159,036 in MCG, which is in excess of the policy limits.

Cause

Management believed that the limits, as stated in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect

The investment of $2,159,036 was not properly authorised. The amount in excess of $1,000,000, i.e. $1,159,036 is therefore questioned as an ineligible cost.

Recommendation

The Contracting Officer should determine the allowability of $1,139,036 in ineligiblequestioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[6] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

L 39 Ostrich Production Namibia ("OPN")

139.1 Export Processing Zone

Criteria

Section 7.C of Enclosure 3 to the Grant Agreement states that "The Grantee shall not use any funds provided under this Grant to establish or develop, or to cause others to establish or develop, in a foreign country any exporting processing zone or designated area in which tax, tariff, labour, environmental or safety laws of that country do not apply, in part or in whole, to activities carried out within such zones or area, unless a prior written determination and certification has been made in accordance with Section 547 that such assistance under this Grant is not likely to cause a loss of jobs within the United States."

Condition

SAEDF invested $2,067,670 in OPN. In a memorandum to the SAEDF Board dated February 13, 1997, it was stated that the "project has been granted Export Processing Zone status which means that Ostrich Production Namibia is exempt from paying all taxes and duties";

SAEDF did not request/obtain the required approval from the Grant's Officer for the investment in OPN.

Cause

Present SAEDF management are unable to state why the required approval was not obtained.

Effect

The statement in OPN was in contravention of the Grant Agreement and could have resulted in job losses in the United States. The investment of $2,067,670 is therefore questioned as an ineligible cost.

Recommendation

The Contracting Officer should determine the allowability of $2,067,670 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

In terms of the Grant Agreement, SAEDF is not permitted to establish or develop an export processing zone in any country. At the time of concluding this transaction, Namibia had already established Export Processing Zones, pursuant to its Export Processing Act of [illegible]. Hence SAEDF, by making this investment, had no hand in establishing or developing the Export Processing Zone. Furthermore, SAEDF obtained advance confirmation from USAID that the investment did not contravene the Grant Agreement. See Appendix MI for copy of letter from USAID dated April 22, 1997.

1.39.2 Interest paid

Criteria

In terms of paragraph 23.a. (1) of USAID OMB Circular A-122; "Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented are unallowable".

Condition

In the loan structure between SAEDF and OPN, SAEDF invested $1,100,000 in a fixed deposit account with Commercial Bank of Namibia ("CBON"). SAEDF then took out a loan of $1,000,000 from CBON and on-lent it to OPN. SAEDF paid $246,481 in interest on this loan.

This structure contravenes the provisions of OMB Circular A-l 22.

Cause

The transaction was structured in this way to hedge against currency devaluations (the loan to OPN was Namibian Dollar denominated).

Effect

The interest paid by SAEDF on the loan from CBON is unallowable in terms of OMB Circular A-122 and the interest of $246,481 is therefore raised as a questioned cost.

Recommendation

The Contracting Officer should determine the allowability of $246,481 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]”

1.40 Pick-a-Spaza Holdings ("PASH")

1.40.1 **Due diligence**

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the abovementioned SAEDF Investment Policies, Guidelines and Procedures Manual requires that the due diligence process must be performed prior to approval and disbursement

Condition

SAEDF invested $1,023,109 and $31,622 in commitment and closing fees in PASH. The due diligence performed on PASH by the SAEDF was superficial and did not address key issues. Furthermore, SAEDF investment associates did not act on certain information obtained during the due diligence process, e.g. the auditors of PASH held shares in PASH, which is a conflict of interest under the rules of their profession.

Cause

Present SAEDF management are unable to state the reason for the investment associates not performing a proper due diligence or not reacting on information obtained.

Effect

The investment was made and SAEDF was not aware of the risk to its investment. PASH subsequently went into liquidation and SAEDF had to write off the entire investment of $1,054,731.',

Recommendation

The Contracting Officer should determine the allowability of $1,054,731 in ineligiblequestioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

1.40.2 **Monitoring of Investment**

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extend to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition

SAEDF disbursed $1,023,109 to PASH and commitment and closing fees of $31,622 during June 1998. The only quarterly report on the investment files was dated August 10, 1999, which was more than a year after disbursement.

There were no financial statements or management accounts for PASH on file.

Investigation by the investment team found that PASH had purchased shares, amounting to R2,6 million, on the Johannesburg Stock Exchange with SAEDF funds. The shares had subsequently been sold but the proceeds could not be traced back to PASH. The funds were, furthermore, used for the repayment of a shareholder's loan account (Mr. Pottas - promoter).

The full investment amount of $1,054,731 in PASH was written off. There is no evidence on file to suggest that SAEDF tried to recover the funds.

Cause

Present SAEDF management were not able to state why the investment was not monitored or an attempt made to recover the funds.

Effect

As a result of poor monitoring, SAEDF found out too late that their funds had been mis-used and had to write off the entire investment in PASH after it's liquidation.

Recommendation

The Contracting Officer should determine the allowability of $1,054,731 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[redacted]

1.40.3 **Investment limits**

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[7]

Condition

AJD. amount of $1,054,731 was invested in PASH, which exceeds the policy limits.

Cause

Management believed that the limits as stated in the criteria were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, the increase was never formally approved by USAID.

Effect

The investment of $1,054,731 is in contravention of the policies, as approved by USAID.The amount in excess of $1,000,000 is therefore questioned.

Recommendation

[7] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

- **The Contracting Officer** should determine the **allowability** of $54,731 **in ineligible questioned** costs and recover **from SAEDF any amounts determined to be unallowable.**

Management comment

[redacted]

[redacted]

[redacted]

1.41 TV Africa ("TVA")/Africa Broadcasting Network ("ABN")

1.41.1 Due diligence

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the SAEDF Board and USAID Grants Officer.

Page 15 of the abovementioned SAEDF Investment Policies, Guidelines and Procedures Manual requires that the due diligence process must be performed prior to approval and disbursement

Condition

The investment of $5,000,000 in ABN was made in April 1999 following a due diligence that was performed by SAEDF staff. In August 1999, SAEDF invested an additional $1,718,238 in ABN.

The initial due diligence performed by SAEDF was not adequate, as it did not identify areas of concern, which were identified 4 months after disbursement Furthermore, the SAEDF staff involved in the due diligence did not undertake sufficient research relating to the amount of capital injection that is needed for a television network.

Cause

Present SAEDF management were unable to state why an inadequate due diligence was performed. -

Effect>

As a result >of the poor due diligence, SAEDF was unaware of the inadequate capitalisation of ABN and eventually was not prepared to accede to the continuous requests for more investment funds. The full investment of $6,718,238 in ABN was ultimately written off.

Recommendation

The Contracting Officer should determine the allowability of $6,718,238 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted].

[redacted]

[redacted]

[redacted]

1.41.2 Investment limits

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved by the SAEDF Board and Grants Officer.

Page 8 of the above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,000,000 or 2% of the fund's value whichever is less".[8] (This limitation refers to initial investments only and not additional funding).

Condition

SAEDF's original investment, made on 29 April 1999, in TVA was $5,000,000, which exceeds the policy limits.

Cause

Management believed that the limits as stated in criteria were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on February 27,1999. However, this increase was never formally approved by USAID,

Effect

The investment of $5,000,000 is in contravention of the policies, as approved by USAID.

The amount in excess of $1,000,000 is therefore questioned.

Recommendation

The Contracting Officer should determine the allowability of $4,000,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

[1] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $1 million threshold as the investment limit in computing questioned costs.

1.41.3 **Indigenous participation**

Criteria

Section E.2 of Enclosure 2 to the Grant Agreement states that; "The Fund will invest only in indigenous firms." "Indigenous" firms, means those with an indigenous majority ownership or a plan to achieve indigenous majority ownership.

Condition

The only other shareholder in ABN after SAEDF's investment was New Africa Advisors ("NAA"). NAA is a wholly owned subsidiary of Sloan Financial Group, a $4 billion Durham, North Carolina financial services group, NAA and its affiliate New Africa Management specialise in providing investment advisory services to US institutional investors.

SAEDF's investment in ABN therefore resulted in 100% of the equity shareholding of ABN being held by US funded organisations.

Cause

Present SAEDF management were unable to state the reason for the investment in ABN.

Effect

The investment in ABN did not benefit an indigenous emerging enterprise and thus contravenes the requirements of the Grant Agreement. It is therefore questioned on these grounds.

Recommendation

The Contracting Officer should determine the allowability of $6,718,238 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

1.41.4 **Monitoring of investment**

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure I, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition

At the SAEDF Directors meeting held on 25-26 September 2000 the problem situations in the investment portfolio were discussed. The first problem investment discussed was TVA and the comments made included the following:

.The company is experiencing capitalization problems as a result of low performance."

Apparently, the company has also been hurt by the departure of New Africa Advisor ("NAA") CEO and the forensic audit of the company currently under way."

The Coca-Cola Company has found the company unable to deliver repeatedly."

Despite these points and the issues identified during the performance appraisal performed in August 1999, SAEDF disbursed an additional $1,718,238 to TVA during 2001.

Cause

Present SAEDF management were unable to state the reason for the decision by the Board to provide additional funding to TVA.

Effect

SAEDF placed its funds at unnecessary risk by disbursing funds to a company that did not appear to have the means of becoming profitable. The entire investment had to be written off.

Recommendation

The Contracting Officer should determine the allowability of $1,718,238 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

L42 *Ubambo Telecommunications (Pty) Ltd ("Ubambo")*

Spirit of the Grant Agreement

Criteria

The mission of the fund listed on Page 4 of the SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 and approved by SAEDF Board and USAID includes to "promote the development of broader capital accumulation by investing in enterprises that are "historically disadvantaged" as a result of former socio-political practices".

Section A of Enclosure 2 to the Grant Agreement states the purpose of the fund "is to encourage the creation and expansion of indigenous small and medium-sized enterprises in the southern Africa region".

Condition

SAEDF invested $59,070 in Ubambo. Ubambo's business plan was to buy-out the interest of the other black economic empowerment entities in the'CellSAf shareholding in order to increase their stake in Cell C (Pty) Ltd, i.e. Ubambo was purchasing the minority shareholders rights in CellSAf to strengthen their own shareholding in Cell C (Pty) Ltd.

This transaction violates the spirit of the Grant Agreement as USAID funds were to be used to buy out minority shareholders (mainly historically disadvantaged individuals), and concentrate their stake in the hands of a few wealthy individuals.

t

The investment was initially approved by the SAEDF Board, but was later stopped by the Board as they realised that the transaction would be against the spirit of the Grant Agreement/[1]

Cause

The cause was due to wilful contravention of the Grant Agreement by SAEDF management

Effect

The amount disbursed in this investment, i.e. $59,070 is questioned as an ineligible cost due to the fact that it is in clear contravention of the spirit of the Grant Agreement.

Recommendation

The Contracting Officer should determine the allowability of $59,070 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

This investment is not in violation of the Grant agreement nor the OMB circular A-122. Charges based upon the spirit of the Grant Agreement may be spurious and unfair because of the subjective nature of interpreting the spirit of the Grant Agreement.

1.43 Vantaris Capital Fund ("VCF")

1.43.1 Monitoring of Investment

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the

Fund will be judged on the extend to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement.

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition

SAEDF invested $949,676 in VCF. There were only annual financial statements for the year ended 29 February 2000 in the investment file. Quarterly reports were not prepared consistently throughout each financial year. (There are no quarterly reports on the file for the last six months of 2000 and also nothing on file for the 2003 financial year. The reports are also not signed as proof that a senior official reviewed it).

The quarterly reports only reflected the financial performances of the companies into which VCF had made investments, it never reflected the results and financial status of VCF as a company.

There are no management accounts on file for VCF.

Cause

SAEDF did not have a formal monitoring policy. SAEDF investment staff did not consistently monitor the investment after the funds were disbursed and did not demand the financial statements and management accounts.

Effect

SAEDF were not in a position to monitor the investment sufficiently without the required financial documents, and were thus not aware of the true financial position of VCF. As a result of this SAEDF did not take all steps necessary to maintain the value of the investment portfolio.

The full investment of $949,676 in VCF had to be written off, arid is questioned as a result of the negligent manner in which SAEDF monitored the investment

Recommendation

The Contracting Officer should determine the allowability of $949,676 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comments

[redacted]

[redacted]

[redacted]

1.43.2 Interest paid

Criteria

In terms of paragraph 23.a(l) of USAID Circular No. A-122; "Costs incurred for interest on borrowe<l capital or temporary use of endowment funds, however represented are unallowable

Interest of $2,554 (including a double interest payment) was paid to VCF due to late payment of drawdowns by SAEDF:

Cause

The late payment of invoices was as a result of the SAEDF finance and accounting personnel not capturing the invoices on a timely basis.

Effect

The condition results in wasted funds due to the payment of interest out of enterprise funds.

Recommendation

The Contracting Officer should determine the allowability of $2,554 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comments

[redacted]

1.433 Maintenance of records

Criteria

Section 2.A of Enclosure 3 to the Agreement states; "The Grantee shall maintain books, records, documents, and other evidence in accordance with generally accepted accounting practice. The Grantee's financial management system shall: (i) provide for accurate, current, and complete disclosure for each Grantee-sponsored activity; (ii) identify adequately the source and application of funds for all Grantee-sponsored activities, and (iii) enable the Grantee to accurately determine Grant balances, book balances and reconciliation of book to Grant balances."

Condition

The following payments to VCF, as per the general ledger, could not be traced to the bank statements for the iAfrica Investment Account, due to the bank statements not being on File:

General ledger	Amount - $ entry date
7 April 2000	$27,333
31 January 2001	,. $21,277
6 July 2001	-, $19,726
Total	**$68^36**

The approved journal voucher (9/34) and supporting calculations relating to the provision for the write-off of the investment in VCF for the amount of $9,927 was not in the journal file.

Cause

Present SAEDF management were unable to state the reason for the condition.

Effect

Without the supporting documentation it is not possible to substantiate the above disbursements/provision.

The disbursed amount of $68,336 as well as the provision of $9,927 is thus questioned as ineligible costs.

Recommendation

The Contracting Officer should determine the allowability of $78,263 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comments

See Appendix F3 for copy of excerpt of SAEDF general ledger indicating journey entry and supporting voucher

1.4 Zambia Pork Products ("ZAPP")

1.44.1 Monitoring of Investment

Criteria

Paragraph G of Modification No. 06 to the Grant Agreements requires that the success of the Fund will be judged on the extent to which the Fund, over the long term, is able to develop an investment portfolio whose inflation adjusted value is at least equal to the amount of funding provided to the Fund for investment.

After disbursement of funds the value of the investment portfolio is achieved through the continuous monitoring of the investment.

The Grant Agreement's enclosure 1, General Provisions, paragraph 9 "Reporting and evaluation", subsection B "progress reviews" states : the focus of the progress reviews will be the exchange of information regarding the overall health and performance of the fund, the current status of future requirements for US Government funding, the funds compliance with the terms of this agreement

Subsection C "office visits" states that USAID will visit the home and field offices of the fund, and a sampling of the firms which have received loans or equity from the funds. In preparation of these field visits, the project officer and /or USAID representative may request current financial information from the fund including the financial statements reported to the fund by investees. USAID does not intend that new reports be prepared for this purpose, but rather would expect to receive working papers that the fund would routinely prepare or receive for its own information. USAID also may request various information related to the monitoring issues listed in subsection D.

Condition

SAEDF disbursed funds of $1,050, 000 to ZAPP in July 1998. ZAPP went into receivership in 2001. Only 5 quarterly reports were prepared during this period.

During the course of SAEDF's investment in ZAPP certain information relating to the use of SAEDF funds and poor internal controls of ZAPP were brought to the attention of SAEDF management. SAEDF, however, did not take any action.

Cause

Present SAEDF management were unable to state the reason for the poor initial monitoring or the lack of decisive action when breaches of the investment conditions were discovered.

Effect

SAEDF were initially unaware of the true status of ZAPP's financial position due to the poor monitoring. When breaches of the investment conditions were discovered, management exposed SAEDF to unnecessary risk by not taking decisive action.

ZAPP was placed into receivership and the total investment in ZAPP written off resulting in the decline of SAEDF's investment portfolio value.

Recommendation

The Contracting Officer should determine the allowability of $1,050,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

1.44.2 Investment limits

Criteria

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the *Grants Officer.* The SAEDF *Investment* Policies, Guidelines and Procedures Manual dated March 1996 that forms part of the Corporate Policies and Procedures, were approved b the SAEDF Board and Grants Officer.

Page Svp^no above-mentioned SAEDF Investment Policies, Guidelines and Procedures Manual states that, for equity investments, the "maximum investment shall not exceed $1,OOd,IWor2% of the fund's value whichever is less".[9]

Condition

SAEDF's initial investment in ZAPP amounted to $1,050,000, which is in excess of the policy limits.

Came

Management believed that the limits, as stated in the criteria, were increased due to the fact that the SAEDF Board increased the Investment Policy Committee's authorisation limit to $5,000,000 during a Board meeting held on 27 February 1999. However, this increase was never formally approved by USAID.

[9] In the absence of a definition of "fund's value", and for the sake of practicality and a conservative approach we have uniformly applied the $I million threshold as the investment limit in computing questioned costs.

Effect

The investment of *$1,050,000* is in contravention of the policies, as approved by USAID. The *amount in* excess of $1,000,000 is therefore questioned.

Recommendation

The Contracting Officer should determine the allowability of $50,000 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

[redacted]

1.45 Ruashi Copper-Cobalt mine

Investment outside target area

Criteria

Section A of Modification No. 06 to the Grant Agreement states: "Against this background, the purpose of the Southern Africa Enterprise Development Fund (the "Fund" or "Grantee") is to encourage the creation and expansion of indigenous emerging enterprises, including small and medium-sized firms, in the southern Africa region, specifically, Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe."

Paragraph C of Modification No.06 to the Grant Agreement states that the grantee shall provide USAID with the Corporate Policies and Procedures, which will be reviewed and approved by the Grants Officer. The SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996, which forms part of the Corporate Policies and Procedures were approved by the Grants Officer.

Page 10 of the SAEDF Investment Policies, Guidelines and Procedures Manual dated March 1996 and approved by the SAEDF Board and USAID states that the fund shall not invest in ventures or transactions involving mining.

Condition

On July 2, 2002 SAEDF disbursed $500,000 (which they subsequently recovered) for a proposed investment in the Ruashi Copper-Cobalt Mine. The transaction however, resulted in a foreign exchange cost of $11,677 to SAEDF. This mine is situated in the Democratic Republic of Congo (DRC), which did not encourage the creation and expansion of indigenous emerging enterprises in the Southern Africa region.

The initial site visit was performed on the 2nd of July 2002. Three employees from SAEDF joined three promoters on a chartered flight to the DRC. SAEDF paid $11,294 relating to a portion of the cost of this flight and accommodation expenses.

Cause

The condition is as a result of wilful non-compliance to the Grant Agreement by the former CEO.

Effect

SAEDF invested in a country outside the area specified in the Grant Agreement and in an industry prohibited by its Investment Policies Guidelines and Procedures Manual. SAEDF recouped the investment that was made in the company but incurred unallowable expenses of $11,294 and a foreign exchange loss of $11,677.

Recommendation

The Contracting Officer should determine the allowability of $22,971 in ineligible questioned costs and recover from SAEDF any amounts determined to be unallowable.

Management comment

[redacted]

[redacted]

As a technical matter, it must be noted that the Grant Agreement forbids investing outside the specified eleven South African countries, nor travel to such unspecified countries.