PD-AAW-046
51530

AUDIT OF
THE ZIMBABWE SHELTER PROJECT
PROJECT NO. 613-HG-001

AUDIT REPORT NO. 3-613-87-17
August 10, 1987

UNITED STATES OF AMERICA

AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT

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

INTERNATIONAL POSTAL ADDRESS
POST OFFICE BOX 30261
NAIROBI, KENYA

August 10, 1987

MEMORANDUM FOR DIRECTOR, RHUDO/ESA, Fredrick A. Hansen

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

SUBJECT: Audit of Zimbabwe Shelter Project

This report presents the results of audit of the Zimbabwe Shelter Project. The Office of the Regional Inspector General for Audit, Nairobi (RIG/A/N) conducted a program results audit of the Zimbabwe Shelter Project to determine if project objectives were being accomplished.

Project objectives were being accomplished. However, two matters needed management attention.

An estimated $1.3 million in future interest earnings were not programmed in the current project delivery plan for the project. The escrow agreement required that all earnings accrued on funds held in the escrow account be used for the benefit of the project. The project delivery plan is the document by which the loan disbursements should be programmed for project use. Both Mission and Government of Zimbabwe officials stated they did not know the escrow agreement required the use of interest earnings in the project. A copy of the Phase II escrow agreement was not available at the mission for reference by the project manager. A copy was available, however, at the responsible Government of Zimbabwe ministry. If interest earnings are not used, the project will lose $1.3 million. Necessary controls should be implemented to ensure that the funds are programmed for the project.

Many of the community facilities in the housing sites did not have electrical power. The project delivery plan required the Government of Zimbabwe to service all project sites with a domestic electricity supply. This situation was caused by lack of foreign currency for the project to use to import necessary electrical components. The lack of foreign currency adversely effected the project and caused degradation of security, educational and health care facilities. The project was adequately funded in U.S. dollars. However, the Government of Zimbabwe did not allocate the required $2.1 million in foreign exchange for the purchase of electrical components.

To resolve the problems above, the report recommends programming future interest earnings in the project delivery plan to assure the earnings are used in the project. The report also recommends withholding future loan disbursements, and clarifying the terms of the agreements and the project delivery plan to require the Government of Zimbabwe to provide foreign currency and domestic electrical power.

Regional Housing and Urban Development Office for East and Southern Africa in Nairobi disagreed with recommendation No. 1, but did not present any evidence which supported their position. Management essentially agreed with recommendation No. 2. Management had already begun implementing recommendation No. 2 by requiring action by the Government of Zimbabwe on the electrification issue.

Please advise me within 30 days of any additional information related to actions planned or taken to implement the recommendations. Thank you for the courtesies extended to my staff during the audit.

EXECUTIVE SUMMARY

In September 1980, A.I.D. approved a $50 million housing guaranty loan project for Zimbabwe. The purpose of the Zimbabwe Shelter Project was to improve the living conditions of the urban poor by providing low-cost housing. This was accomplished by providing housing construction loans to eligible low income families.

The project was divided into two phases of $25 million each. Phase I objectives included the construction of approximately 10,000 low cost housing units and community facilities, i.e., schools and clinics. Phase II objectives included the construction of 6,000 low cost housing units and community facilities. All project housing sites were to be fully serviced with roads, stormwater drainage, security lighting, water, sewer, and domestic electricity supply.

The Office of the Regional Inspector General for Audit, Nairobi, conducted a program results audit of the Zimbabwe Shelter Project. The audit's purpose was to determine if project objectives were being achieved.

Project objectives were being accomplished although certain problems needed resolution. One problem involved the potential loss of an estimated $1.3 million in future interest earnings, which should be used in the project.

Another problem was the project's lack of foreign exchange to purchase necessary electrical components to provide electrical power at the housing sites. The project was funded by the United States in U.S. dollars. However, the Government of Zimbabwe did not make dollars available to fund the foreign exchange needs of the project.

An estimated $1.3 million in future interest earnings were not programmed in the current project delivery plan for the project. The escrow agreement required that all earnings accrued on funds held in the escrow account be used for the benefit of the project. Both Mission and Government of Zimbabwe officials stated that they did not know the escrow agreement required the use of interest earnings in the project. A copy of the Phase II escrow agreement was not available at the Mission for reference by the project manager. A copy was available, however, at the responsible Government of Zimbabwe ministry. If interest earnings are not used as required, the project will lose $1.3 million that could be used toward project goals. Necessary controls should be implemented to ensure that the funds are programmed for the project. The report recommends that the Regional Housing and Urban Development Office for East and Southern Africa, program interest earnings in the project delivery plan, or make a written decision on how these funds will be used. Management disagreed with this recommendation, but did not present any evidence which supported their position.

Many of the community facilities in the housing sites did not have an electricity supply. The project delivery plan required the Government of Zimbabwe to service all project sites with a domestic electricity supply. The sites were not supplied because the Government did not provide the project with the foreign currency needed to import required electrical components. Even though the project was adequately funded in U.S. dollars, the Government did not allocate any of it to use as foreign exchange for the purchase of $2.1 million of needed electrical components. As a result, there was a significant decrease in project results, including degradation of security, educational and health care facilities. The report recommends that the Regional Housing and Urban Development Office of East and Southern Africa authorize no further loan disbursements until the Government of Zimbabwe has allocated foreign exchange for the procurement of electrical components, and that a Project Implementation Letter be issued to the Government clarifying the requirement to provide the domestic electrical power supply. Management agreed with this recommendation.

Management and the Office of Inspector General comments to the report recommendations are summarized after each finding. A copy of management comments relevant to report content, conclusions and recommendations is included as Appendix 1 to the report.

Office of the Inspector General

AUDIT OF
THE ZIMBABWE SHELTER PROJECT

TABLE OF CONTENTS

AUDIT OF
THE ZIMBABWE SHELTER PROJECT

PART I - INTRODUCTION

A. Background

In September 1980, A.I.D. approved a $50 million housing guaranty loan project for Zimbabwe. The purpose of the Zimbabwe Shelter Project was to improve the living conditions of the urban poor by providing low-cost housing. This was accomplished by providing housing construction loans to eligible low income families.

The project was divided into two phases of $25 million each. Phase I objectives included the construction of approximately 10,000 low cost housing units and community facilities, i.e., schools, clinics, etc. Phase II objectives included the construction of 6,000 low cost housing units and community facilities. All project housing sites were to be fully serviced with roads, stormwater drainage, security lighting, water, sewer, and domestic electricity supply. A technical assistance grant for $750,000 was approved in July 1982 to complement the loan guaranty project. The loan-funded portion of the project had no project assistance completion date. The completion date for the grant-funded portion was June 30, 1987.

The $50 million loan was split into two authorizations (Phase I and Phase II) of $25 million each. The Phase I implementation agreement between A.I.D. and the Government of Zimbabwe for $25 million was signed in January 1982, and provided for low-cost housing in Chitungwiza and Kuwadzana, two suburban areas of the capital city, Harare. Phase II was signed in November 1982 for another $25 million to cover low-cost housing, primarily in secondary towns in other areas of Zimbabwe.

The first loan disbursement was not made until May 1982, almost two years after A.I.D. approved the housing guaranty loan project. The delay was due to disagreement between A.I.D. and the Government of Zimbabwe on certain housing policy issues.

The Regional Housing and Urban Development Office for East and Southern African (RHUDO/ESA) in Nairobi, Kenya was responsible for the technical oversight of the project, including the approval for loan disbursements to the Government of Zimbabwe. USAID/Zimbabwe was responsible for the daily management of the project.

The Phase I authorization of $25 million and interest earnings of about $1 million from escrow funds were completely disbursed to the Government of Zimbabwe, but only $16 million of the Phase II authorization was disbursed. As of December 1986, total disbursements were $41.5 million in principal (83 percent of the total $50 million authorized) and about $1 million in interest earnings on loan funds which were held in escrow.

The undisbursed principal balance from Phase II amounted to $8.5 million as of December 1986. This amount was scheduled for disbursement through 1989. The balance of the low-cost homes were expected to be completed by the end of 1989. All but $17,000 of the $750,000 grant funding had been expended over both phases of the project.

The Government of Zimbabwe contributions to the project totalled about $14.6 million as of December 1986. This represented 35 percent of the loan disbursements of $41.5 million at that time. The project delivery plan called for the Government of Zimbabwe to contribute about $23 million in addition to the total authorized $50 million loan.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Nairobi (RIG/A/N) conducted a program results audit of the Zimbabwe Shelter Project to determine if project objectives were being achieved. This was the first audit of the Zimbabwe Shelter Project.

The audit was performed during April and May 1987 in Harare, Zimbabwe and Nairobi, Kenya. Loan and grant documents were reviewed at RHUDO/ESA in Nairobi. Discussions with local authorities were held during site visits to several project housing areas in Zimbabwe, including Kuwadzana, Marondera, and Chitungwiza. Discussions also were held with responsible officials at USAID/Zimbabwe, RHUDO/ESA, the Government of Zimbabwe Ministry of Finance and Economic Planning Development, and the Ministry of Public Construction and National Housing. Government financial records supporting the receipt of loan funds were examined.

The audit covered the period from the initial loan authorization in January 1982 to May 1987. The funds audited included $41.5 million in disbursements of the total $50 million authorized loan, accrued interest of $2.4 million, and a $750,000 grant. Counterpart contributions totalling about $14.6 million were also reviewed. The examination of internal controls was limited to the problem areas identified in the audit. The audit was made in accordance with generally accepted Government auditing standards.

AUDIT OF
THE ZIMBABWE SHELTER PROJECT

PART II - RESULTS OF AUDIT

Project objectives were being accomplished although two problems needed resolution. One problem involved the potential loss of an estimated $1.3 million in future interest earnings which should be used in the project. Another problem was the project's lack of foreign exchange to purchase necessary electrical components to provide electrical power at the housing sites.

The project was funded by the United States in U.S. dollars. The Government of Zimbabwe only used local currency to pay the costs of the project, although it should have used some of the U.S. dollars to fund the foreign exchange needs of the project.

Two events allowed the project to expand from 5 to 10 housing sites, and increase housing units from 16,000 to 19,000. First, an exchange devaluation resulted in the project receiving an additional equivalent of approximately $4.8 million (Zimbabwe dollars 8 million). Next, accrued interest earnings of $1.4 million were programmed and approved for project use. Both events benefited the project by providing unexpected additional funds.

To resolve the project's problems, the report recommends programming future interest earnings in the project delivery plan to assure they are used in the project. The report also recommends withholding future loan disbursements, and clarifying the terms of the agreements and the project delivery plan to require the Government of Zimbabwe to provide foreign currency and domestic electrical power.

A. Findings and Recommendations

1. Future Interest May Not Be Used For Project Purposes

An estimated $1.3 million in future interest earnings were not programmed in the current project delivery plan for the project. The escrow agreement required that all earnings accrued on funds held in the escrow account be used for the benefit of the project. Both Mission officials and Government of Zimbabwe officials stated that they did not know the escrow agreement required the use of interest earnings in the project. A copy of the Phase II escrow agreement was not available at the mission for reference by the project manager. A copy was available, however, at the responsible Government of Zimbabwe ministry. If interest earnings are not used, the project will lose $1.3 million. Necessary controls should be implemented to ensure that the funds are programmed for the project.

Recommendation No. 1

We recommend that Regional Housing and Urban Development Office East and Southern Africa (RHUDO/ESA):

a. program in the project delivery plan the estimated $1.3 million in future interest earnings on the balance of funds to be disbursed from the escrow account, or make a decision in writing on how these funds will be used, and

b. communicate to the Government of Zimbabwe the terms of the Phase I implementation agreement and the Phase II escrow agreement which required interest earnings be used for project purposes.

Discussion - Future loan interest earnings estimated at $1.3 million accruing in the Phase II escrow account were not programmed into the project delivery plan. Responsible officials of the USAID/Zimbabwe mission stated that they did not know of the requirement that interest earnings be used in the project. A copy of the escrow agreement was not available at the Mission for reference by the project manager.

However, the Phase I implementation agreement and the Phase II escrow agreement required that all earnings on escrow funds be used for the benefit of the project. The specific language of both agreements stated that "The Borrower shall use its best efforts to apply all earnings accrued on funds deposited into the escrow account for the purpose of financing the Project in the manner prescribed in the implementation agreement, or in such other manner as A.I.D. may agree to in writing."

Although the Government of Zimbabwe had a copy of the escrow agreement, officials mistakenly believed they had discretionary use of interest earnings on escrow funds primarily because regular interest payments were being made on the loan principal. This indicated the provisions of the escrow agreement regarding the disposition of interest were not known by the Government of Zimbabwe decision-making officials.

USAID/Zimbabwe officials also were not aware of the terms of the Phase II escrow agreement. Nevertheless, the Mission requested that interest accrued as of July 1986 be programmed in the project delivery plan. This request was made in November 1986. Mission officials made this request because they believed good management practice required the use of these funds for the project.

The Government of Zimbabwe did not respond immediately to the Mission's request. USAID/Zimbabwe informed the audit staff that a decision was expected soon by the Government of Zimbabwe. Unfortunately, this was about five months after the request had been made.

During the course of the audit, the audit staff explained to the Government of Zimbabwe the requirements of the escrow agreement with respect to interest earnings, which totaled $2.7 million. Shortly thereafter the Government of Zimbabwe agreed to use the interest earnings in the project by approving the project delivery plan. However, only $1.4 million was programmed.

Thus, the Phase II interest earnings were only partially programmed. About $1.3 million will accrue in addition to the $1.4 million already programmed. Safeguards should be implemented to ensure the estimated $1.3 million in future interest earnings will be used for project purposes.

The project delivery plan is the primary disbursing document and operational reference. It is approved by both A.I.D. and the Government of Zimbabwe. All loan funds including accruing interest and estimated future interest must be programmed and budgeted in the project delivery plan. This ensures that funding will be properly used and accounted for.

Management Comments

RHUDO/ESA disagreed with the finding. RHUDO/ESA's comments centered around the point that it was their intent rather than the written agreements that should prevail. Among their comments were:

-- The Phase II implementation agreement is the basic project agreement and makes no mention of any restrictions on escrow earnings because the Zimbabweans would not agree to any restrictions on escrow earnings;

-- The escrow agreements terms are merely "Boiler Plate Language";

-- Even if the escrow agreement is binding, the amount earned on the escrow account is less than the amount of interest paid by the Government of Zimbabwe on equivalent loan funds. Therefore, the Government of Zimbabwe "lost" money on the escrow account;

-- Escrow funds can be used for any purpose approved in writing by A.I.D. and there is no presumption that they be used for low cost shelter; and

-- Interest proceeds cannot be lost because funds can only be disbursed with joint instruction from A.I.D. and the Government of Zimbabwe.

RHUDO/ESA's comments are presented in their entirety in Appendix 1.

Office of the Inspector General Comments

We evaluated RHUDO/ESA's comments very carefully and came to the following conclusions:

-- The comment that the implementation agreement is the basic agreement (and therefore binding) did not change our conclusions. The implementation agreement in fact was silent on this subject and does not, therefore, contradict the only written agreement between the two parties - the escrow agreement.

-- The escrow agreement does directly address how the funds are to be used as well as how they are to be disbursed. In the absence of any evidence to the contrary - and RHUDO/ESA presented no other evidence - the only conclusion possible is that the escrow agreement should prevail since it is the only evidence of the intent of both parties.

-- The comments that the Government of Zimbabwe lost money on the escrow account are irrelevant. The escrow agreement does not discuss profit or loss but instead speaks only to earnings and how they are to be used and controlled. The fact that the Government of Zimbabwe paid more interest on their loan than it earned on Treasury notes in the escrow account (RHUDO/ESA presents no specifics on this by the way) has no relevance to the validity of its agreements with A.I.D.

-- The comments that the funds can be used for any purpose approved in writing by A.I.D. is correct. However, no other purpose was approved by A.I.D. in writing and this comment again begs the point.

-- The comment that interest proceeds cannot be lost because funds can only be disbursed with joint instructions from A.I.D. and the Government of Zimbabwe was true in theory but not in practice. The compliance section of this report depicts a transaction in which the Government of Zimbabwe withdrew $1.9 million from this escrow account without A.I.D.'s prior knowledge or consent.

2. Many Facilities Did Not Have Electrical Power

Many of the community facilities in the housing sites did not have an electricity supply. The project delivery plan required the Government of Zimbabwe to service all project sites with a domestic electricity supply. The sites were not supplied because the Government did not provide the project with the foreign currency needed to import required electrical components. Even though the project was adequately funded in U.S. dollars, the Government did not allocate any of it to use as foreign exchange for the purchase of $2.1 million of needed electrical components. The effect of the situation was a significant decrease in project results, including degradation of security, educational and health care facilities.

Recommendation No. 2

We recommend that Regional Housing and Urban Development Office, East and Southern Africa:

a. authorize no additional loan disbursements until the Government of Zimbabwe has allocated foreign exchange for the procurement of electrical parts, and

b. issue a Project Implementation Letter to the Government of Zimbabwe that furnishes additional specific information about the requirements for the Government to provide the domestic electrical power supply. The implementation letter should direct the Borrower to utilize foreign currency from the proceeds of the loan as a source of foreign exchange for the purchase of electrical parts.

Discussion - Site visits to Kuwadzana, Marondera and Chitungwiza disclosed the following electricity supply problems (See Exhibits 1 and 2):

-- At Kuwadzana several schools and a clinic were completed, but had no electrical power. Also about 42 security lights were not operating due to a lack of electrical power. The security lights were used to provide night time lighting to the entire housing site. About 40,000 residents lived at the housing site in about 7,000 residencies. However, only about 68 residencies had electricity including the housing administrative office.

-- At Marondera, about one-third of the 1,000 target housing units had been completed. Only 26 of the 332 units completed had electricity. However, at Marondera, the common facilities and the security lights did have electrical power.

-- At Chitungwiza, no problems were discovered which related to the servicing, i.e., security lighting, electricity, etc, at the project housing site.

The specific criteria that required the Government of Zimbabwe to address the electricity problem was stated in the project delivery plan. It stated, "All project sites are to be fully serviced with roads, stormwater drainage, water and sewer reticulation, security lighting and domestic electricity supply."

Additional criteria relating to the Government of Zimbabwe's ability to fulfill the electricity requirements was stated in Section 3.01 of the Phase I implementation agreement. The section required that proceeds of the loan be used to finance the eligible foreign exchange. This requirement is particularly important because the lack of electricity was caused by the Government of Zimbabwe's failure to provide the necessary foreign exchange.

Also, Section 3.03 of the Phase I implementation agreement and Section 3.02 of the Phase II implementation agreement required that the Borrower agree to provide or cause to be provided for the project any additional funds, and other resources required to carry out the project effectively and in a timely manner.

The Government's reluctance to allocate foreign currency was prompted by a foreign currency shortage which had persisted in Zimbabwe since independence in 1980. This project was adequately funded in U.S. dollars and this situation should have been addressed by allocating foreign exchange from the loan proceeds. However, such an allocation was not made and the foreign currency with which the project was funded went to the Government of Zimbabwe's Treasury, and was used for other purposes.

The Government of Zimbabwe's failure to allocate the foreign exchange needed for the project seriously impeded the project's success. Foreign currency was necessary for the project so that the electrical components could be imported. The imported components required to provide electrical power to the housing sites included transformers, switches, and relays.

The lack of foreign currency adversely effected the project and caused degradation of security, educational and health care facilities. About $2.1 million in foreign currency should have been allocated from the loan proceeds to resolve this problem for 9 of the 10 housing sites. That amount was not used by the Government of Zimbabwe for the purchase of electrical parts to provide power for all of the housing sites, thereby affecting four of the five housing sites under development. There were five additional housing sites where construction had not yet begun. These additional sites will also be affected by a lack of electrical power unless the problem is resolved. Priority should be given to those housing sites where there is no power for the security lights, because lack of lighting imposes a serious security risk for the residents. Facilities such as schools, clinics, and other public accommodations should also receive priority attention.

This problem should be addressed immediately. It is recognized that USAID/Zimbabwe has made efforts by holding discussions with Government of Zimbabwe officials in an attempt to resolve this issue. The Government of Zimbabwe officials suggested that they could identify a bilateral commodity import program under which an allocation would be made for the necessary electrical components. RHUDO/ESA has the authority for the approval of loan disbursements and necessary action as recommended should be taken.

Management Comments

RHUDO/ESA essentially agreed with this finding. Management had already begun implementing Recommendation No. 2 by requiring action by the Government of Zimbabwe on the electrification issue.

Office of Inspector General Comments

Management suggested certain changes to clarify the electrification issue. The final report was changed to incorporate the suggested changes.

B. Compliance and Internal Controls

Compliance

As discussed in Finding No. 1 of this report, the USAID/Zimbabwe mission had not programmed an estimated $1.3 million in the project delivery plan. This amount represented future interest earnings which were required by the terms of the escrow agreement to be used in the project.

As discussed in Finding No. 2 of this report, the Government of Zimbabwe had not provided the necessary foreign exchange to provide for the importation of electrical components. The problem persisted through both phases of the project. This violated the Phase I implementation agreement which required, that the proceeds of the loan be used to finance the eligible foreign exchange. The Phase II implementation agreement stipulated that the Borrower agree to provide other required resources.

Government of Zimbabwe made a premature unauthorized drawdown of $1.9 million in violation of the escrow agreement. The transaction occurred because a bank official authorized the release of funds at Government of Zimbabwe's request, without A.I.D.'s written approval. The bank is no longer the escrow agent for this shelter project. This matter was referred to the Inspector General's Legal Counsel for disposition. Though this issue was a clear violation of the escrow agreement, Counsel determined that there was no basis for a claim of lost interest or other recovery.

The review of compliance was limited to the finding areas presented in this report.

Internal Control

The review of internal controls was limited to the problem areas identified during the audit.

C. Other Pertinent Matters

Annual audits of the total loan as required by the Phase I and Phase II implementation agreements have not been made. RHUDO/ESA should require the Government of Zimbabwe to comply with the terms of the implementation agreement during the balance of the loan disbursements.

The Phase I and Phase II implementation agreements required that A.I.D. be given appropriate recognition for its funding assistance of the project. One of the sites visited (Kuwadzana) did not have an A.I.D. publicity sign. Another site (Marondera) had a sign in place, but it was not considered to be adequate for the recognition of A.I.D.'s substantial contribution (See Exhibit 2). RHUDO/ESA has agreed to take action on this matter and ensure that the appropriate publicity signs are installed at all existing and future sites.

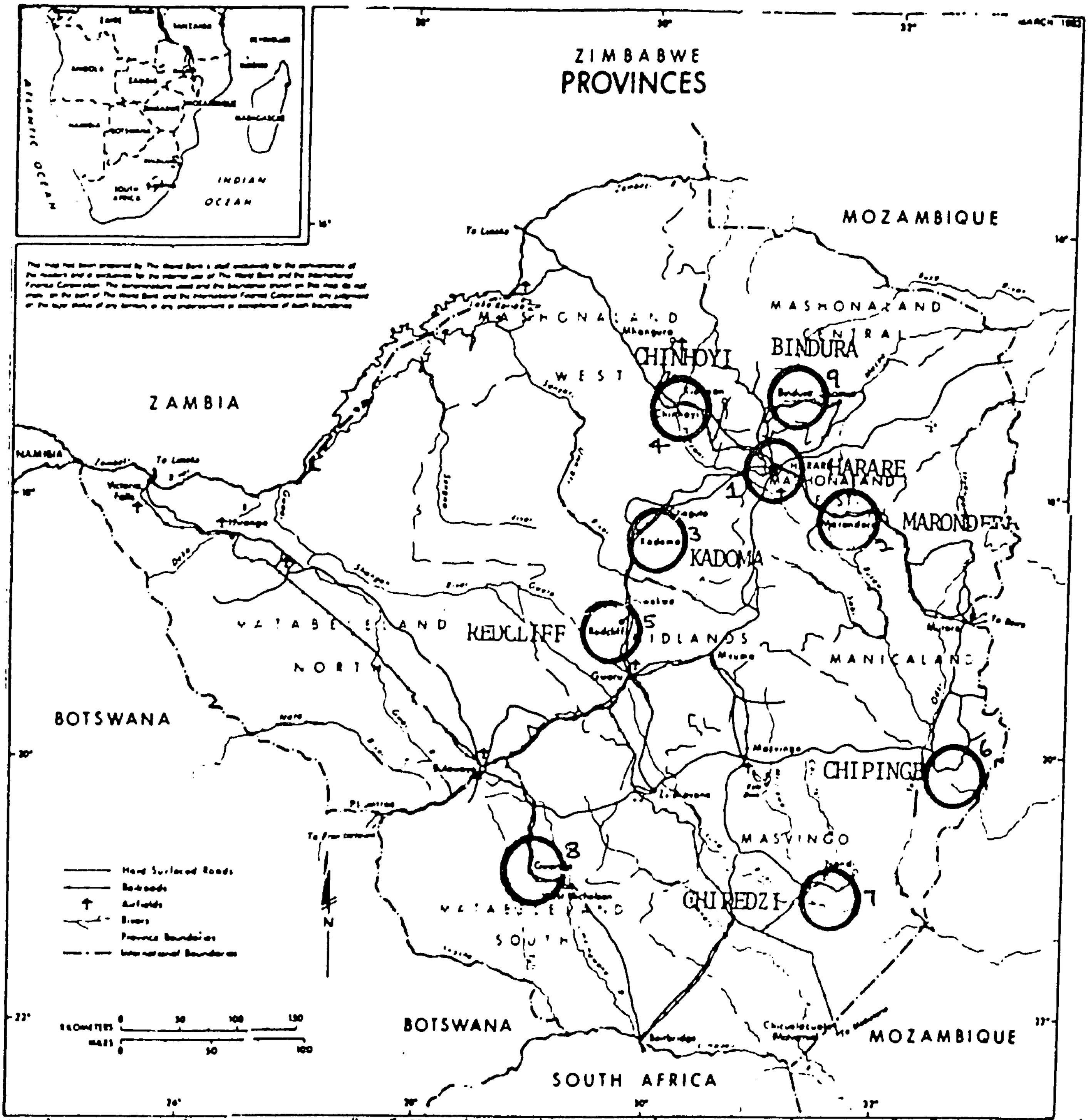
The Phase I interest earned on the escrow funds of about $1 million was not programmed in the project delivery plan. We did not report this issue as an audit finding because the Government of Zimbabwe would make significant contributions to the project by completion and a significant loss could not be proven.

AUDIT OF
THE ZIMBABWE SHELTER PROJECT

PART III - EXHIBITS AND APPENDICES

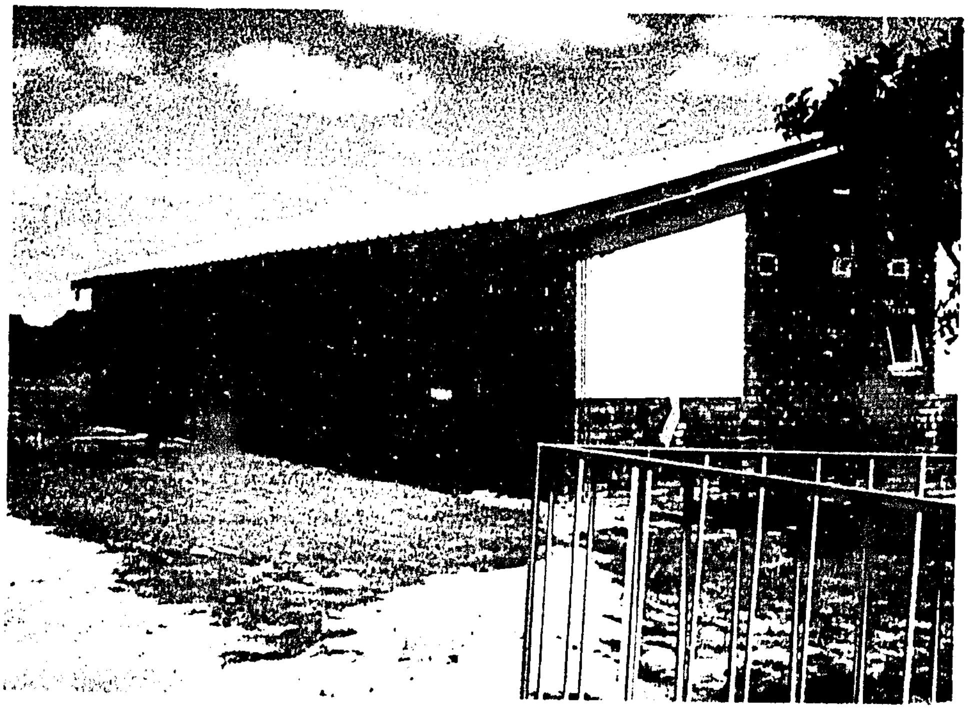
EXHIBIT 1

Map of Zimbabwe

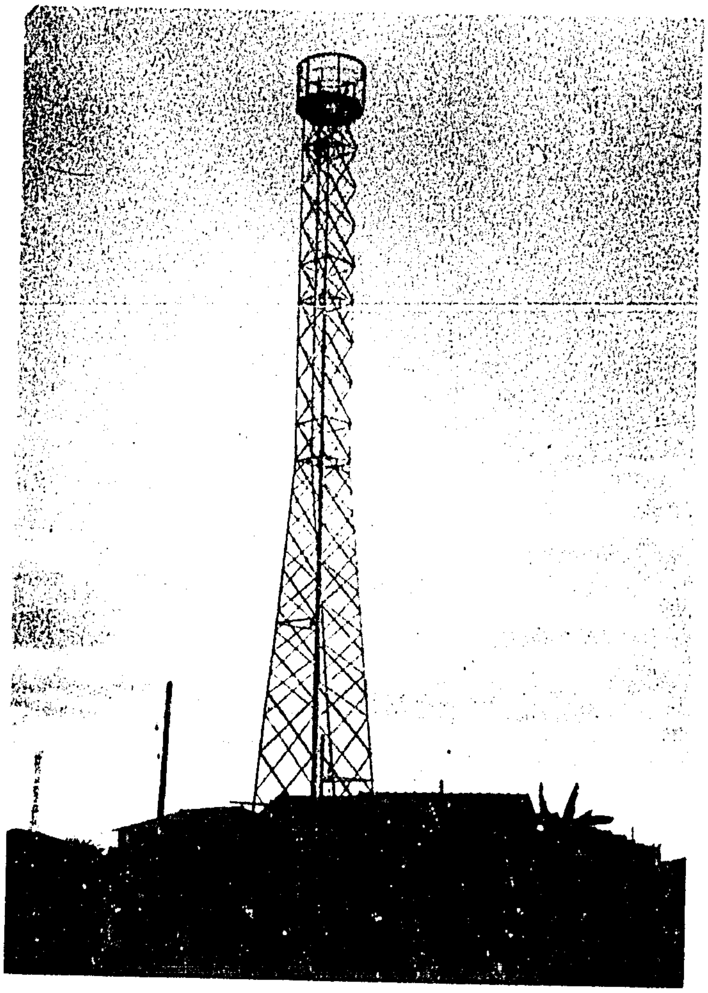


Project Town Sites	# of Housing Units	Project Town Sites	# of Housing Unit
1. Harare - Chitungwiza	7,680	Balance B/F	17,559
- Kuwadzana	7,398	5. Redcliff	800
2. Marondera	1,035	6. Chipinge	200
3. Kadoma	946	7. Chiredzi	300
4. Chinhoyi	500	8. Gwanda	200
		9. Bindura	300
Balance C/F	17,559	Total	19,359

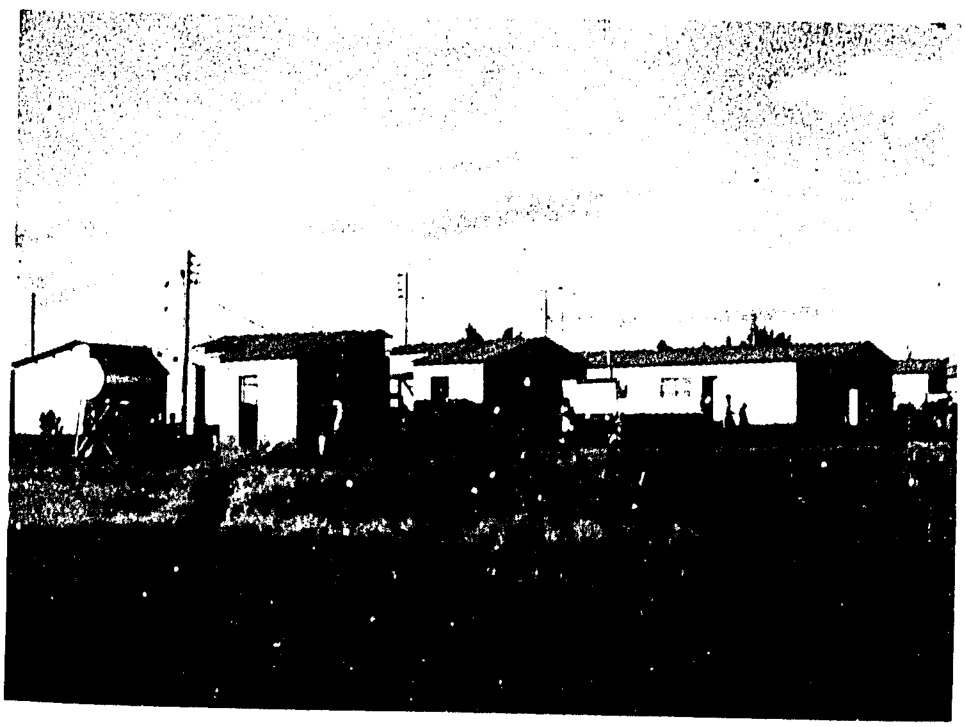
MARONDERA: Poor publicity sign of Project housing site



KUWADZANA: Completed and functioning Primary School without electricity



KUWADZANA: Tower without security light



KUWADZANA: Completed and occupied housing units with electricity

UNITED STATES GOVERNMENT

memorandum

DATE: July 28, 1987

REPLY TO ATTN OF: Fredrik A. Hansen, Director, RHUDO/ESA Peter Feiden For

SUBJECT: Audit of the Zimbabwe Shelter Project, No. 613-HG-001, Audit Report No. 3-613-87, July 1987

TO: Richard Thabet, RIG/A

I have the following comments on the draft audit report for the Zimbabwe Shelter Project (613-HG-001), which I hope you will take into account before finalizing the report.

1. Use of escrow earnings. I disagree with the report's characterization of escrow interest earnings under the project.

   The Implementation Agreement is the basic project ag.eement between AID and the Government of Zimbabwe. During negotiations on the phase II agreement, the Zimbabweans (Ministry of Finance) would not agree to include any restrictions on earnings on escrowed funds, as had been agreed to in Phase I. Accordingly, the Implementation Agreement makes no mention of escrow earnings. Although reference is made to escrow earnings in the escrow agreement, this is "boiler-plate language" in an agreement concerned with the mechanics of how money is disbursed. The added power it affords USAID is not meant to undercut the agreements reached with the Government of Zimbabwe and embodied (or specifically not embodied in this case) in the Implementation Agreement.

   Accepting for the minute that the escrow agreement is binding in this case, there have in fact been no earnings on the escrow account. The Government of Zimbabwe is bound to pay interest on all funds borrowed (disbursed and escrowed) from the date of borrowing. On balance, the Government of Zimbabwe lost money on the escrow account. The loan interest rate is 40 basis points over the 26 week treasury bill rate, to which USAID charges an additional 0.5 percent guaranty fee.

The escrowed funds are ordinarily invested in U.S. Government securities of similar maturity. Hence Zimbabwe loses nearly one percent per year on escrowed funds. The term "earnings" should rightly apply to any escrow interest paid in and above what the Government is paying out in interest on those funds. Although we would as a matter of course approve all escrow interest disbursements, and in fact prefer to have this authority, in doing so we would not be confirming that these actually represented "earnings".

Putting the actual definition of earnings aside, the escrow funds can be used for any purpose so approved by AID ("in such other manner as AID may agree to in writing"). There is no presumption that these earnings be used for low-cost shelter. The statements (e.g. pp. 7, 8) that these funds must be used in the project are simply incorrect.

It is not possible, as you state in the report (pp.7, 8), for us to lose the interest proceeds. These funds are held in an escrow account from which funds can only be disbursed with the joint instruction of AID and the Government of Zimbabwe. Hence, no additional safeguards (as you suggest pp.7, 10) are necessary.

We have in fact done one programming of interest accrued on the escrow account, which we now know is in excess of original program expenditures. This was accomplished by RHUDO presenting the idea to the Ministry of Housing and when they concurred, the case was made and subsequently approved by the Ministry of Finance. The Government of Zimbabwe is well aware that more funds are available, and they are in the process of deciding how they would wish to use the funds. The fact that exact programming of all these funds has not as yet occurred does not indicate any disagreement with the GOZ or foot dragging on their part. They have found the formula of low-cost housing delivery that we developed with them and applied in Harare and now secondary towns so successful that they decided to expand the system using the interest earned to date on the escrow account to other towns, Bindura and Gwanda. (Projects in Redcliff, Chiredzi, and Chipinge are being funded by loan principal available due to devaluations). However, the implementation capacity of the Ministry and the towns is such that we cannot expect them to rapidly come back to us and identify additional sites for these types of projects, if in fact they do continue to use escrow interest in this manner.

It is not unusual for a mission not to be aware of HG project agreement details. The RHUDO has the delegated authority for HG project implementation and we take charge of all substantive issues. Once the Mission decides to pursue a HG project and approves its basic outline, its involvement is essentially limited to monitoring the reports of the RHUDO and its contractors. In the case of Zimbabwe, a very competent PSC was working under the direction of the RHUDO in the mission solely on the HG project. He fully understood the escrow issue, and it would be normal practice for the mission to defer to RHUDO and the PSC expertise on any details.

2. Electrification

I believe we have reasonably addressed the issue of electrification. In fact, while the audit was going on we responded to a GOZ disbursement request by requiring action on the electrification issue and have since received a positive response. (See attachments)

The audit report incorrectly states that homes are to be provided with electricity. Residential electrical hookups are not included under the project. Rather, the electricity is for security lighting, community facilities, and reticulation in residential areas sufficient for house by house hookup at the owner's discretion and expense.

The report notes that $2.1 million in foreign exchange has not been allocated for electrification. The particular foreign exchange of the HG project is not segregated for project purposes. The $2.1 million is simply an estimate of the hard currency electrification costs for all nine sub-projects. Five of these projects are not yet under construction, and at this point we have no reason to expect that the future contractors will have any delays in acquiring the foreign exchange necessary for purchasing the electrical components to complete their work. We will of course continue to monitor the situation for all nine towns.

Attachments: Harare 003795
Ministry of Finance, Economic Planning and Development letter Reference A/96/1/19 of (July 6, 1987).

cc: D/PRE/H, P. Kimm
AID/Zimbabwe, A. Herrick

ACTION: AID-4 INFO: ECON - 5

VZCZ...0704 15-JUL-87
PP RUE...
DE RU... #3795 1961750 CNG: AID
ZNR UUUUU ZZH DIST: AID
R 141... JUL 87 ADD:
FM AMEMBASSY HARARE
TO AMEMBASSY NAIROBI 8927
BT
UNCLAS HARARE 03795

AIDAC

FOR RHUDO

E.O. 12356: N/A
SUBJECT: HOUSING GUARANTY LOAN 613-HG-201(C)

REF: NAIROBI 1666

1. BY LETTER DATED JUNE 9, 1987, MISSION INFORMED GOZ OF THE THREE CONDITIONS THEY MUST MEET FOR RHUDO TO APPROVE DISBURSEMENT OF US DOLS 2 MILLION FROM THE ESCROW ACCOUNT FOR SUBJECT LOAN AS SET OUT IN REFTEL.

2. IN RECENT LETTER DATED JULY 6, MINISTRY OF FINANCE ADVISED US THAT THE USDOLS 500,000 REQUIRED FOR THE PURCHASE OF ELECTRICAL SUPPLIES FOR KUWADZANA WILL BE MET USING FUNDS SUPPLIED UNDER THE DUTCH COMMODITY IMPORT PROGRAM. THE LOCAL PHILIPS COMPANY WILL RECEIVE A FX ALLOCATION TO COVER THE IMPORT OF THE EQUIPMENT NEEDED BY HARARE MUNICIPALITY.

3. THE REMAINING TWO ISSUES REGARDING THE FUNDING OF THREE PRIMARY SCHOOLS AT KUWADZANA AND THE BORROWING POWER TO THE TOWNS OF REDCLIFF, CHIREDZI AND CHIPINGE ARE STILL BEING WORKED OUT. MISSION WILL ADVISE RHUDO WHEN THESE TWO CONDITIONS ARE MET. RAWLINGS
BT
#3795

NNNN

20

Telegrams: "MINFIN"
Telex: 2141
Telephones: 22101, 794571
Private Bag 7705, Causeway

ZIMBABWE

MINISTRY OF FINANCE, ECONOMIC
PLANNING AND DEVELOPMENT,
Munhumutapa Building,
Samora Machel Avenue,
Harare.

F.H
PF

6 July 1987

Mrs P Hussey
The Acting Director
USAID
P O Box 3340
HARARE

File [illegible]
col(c

Dear Mrs Hussey

RE : USAID HOUSING GUARANTY LOAN 613-HG-001(B)

I am pleased to refer to your letter dated June 9, 1987 in respect of the disbursement of US$2 000 000 requested by our Government and the conditions stipulated therein.

I wish to advise you that one of the conditions stipulating the allocation of US$500 000 in foreign currency for the purchase of electrical supplies will be satisfied under a Commodity Import Programme. The other two issues regarding the funding of three primary schools at Kuwadzana and the borrowing power to the towns of Redcliff, Chiredzi and Chipinge will be dealt with under seperate cover.

The prupose of this letter is therefore to brief you on the current state of affairs regarding the three conditions laid down in your letter and specifically to make an undertaking that the foreign currency will be made available for the purchase of electrical supplies.

Yours sincerely

C Kanyuchi
for: SECRETARY FOR FINANCE
ECONOMIC PLANNING AND DEVELOPMENT

/ts

DATE JUL 10 1987

	ACTION	INFO
DIR		✓
DD/		✓
DD SARP		
PROG	✓	
CONT		
CMO		
ADO		
HRDO		
RUGS		
MGMT		
CHRON		✓
RF		✓

DUE DATE 7-16-87
ACTION TAKEN ____
INITIALS DATE ____

ri

APPENDIX 2

REPORT DISTRIBUTION

Director, RHUDO/ESA	5
Director, USAID/Zimbabwe	1
AA/AFR	1
REDSO/ESA	1
AFR/SA/ZMBL	1
AFR/CONT	1
AA/XA	2
XA/PR	1
LEG	1
GC	1
AA/M	2
M/FM/ASD	2
SAA/S&T	1
PPC/CDIE	3
IG	1
DIG	1
IG/PPO	2
IG/LC	1
IG/EMS/C&R	12
AIG/II	1
RIG/II/N	1
IG/PSA	1
RIG/A/C	1
RIG/A/D	1
RIG/A/M	1
RIG/A/S	1
RIG/A/T	1
RIG/A/W	1
RFMC/Nairobi	1

W