

P.D. May-002

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AUDIT OF THE FLOW OF A.I.D.
ASSISTANCE FUNDS TO THE MALAWI
MINISTRY OF AGRICULTURE

AUDIT REPORT NO. 3-612-88-17
JUNE 30, 1988

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT

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June 30, 1988

MEMORANDUM FOR DIRECTOR, USAID/Malawi, John F. Hicks
FROM: RIG/A/Nairobi, Richard C. Thabet *Richard C. Thabet*
SUBJECT: Audit of the Flow of A.I.D. Assistance Funds
to the Malawi Ministry of Agriculture

The Office of the Regional Inspector General for Audit, Nairobi has completed its audit of the flow of A.I.D. assistance funds to the Malawi Ministry of Agriculture. Five copies of the audit report are enclosed for your action.

The draft report was submitted for your comments and your comments are attached to the report as Appendix 1. The report has one recommendation. Recommendation No. 1a is considered closed. Recommendation No. 1b is resolved but will not be closed until completion of planned or promised actions. Please advise me within 30 days of any additional information relating to actions planned or taken to implement recommendation No. 1b.

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

Background

The Government of Malawi's Ministry of Agriculture (MOA) supported Malawi's most important economic activity. Agriculture employed 85 percent of the labor force, and generated 40 percent of the country's gross domestic product and 85 percent of its foreign exchange.

USAID/Malawi supported the MOA through three project grants with obligations totalling \$24.9 million. The grants' funds were conveyed two ways: (i) USAID/Malawi directly paid vendors for goods and services, or (ii) USAID/Malawi reimbursed the Ministry for costs already incurred.

Under the second method, the MOA first paid for goods and services and then submitted claims for reimbursement to USAID/Malawi. In order to claim reimbursement the MOA had to segregate the costs pertaining to the A.I.D. supported activities and list them on a summary statement of expenditures to support the claim. The Mission did not require the MOA to submit paid vouchers and receipts to support the summary statement of expenditures, and in fact was not required to do so by A.I.D. regulations.

Audit Objectives and Scope

The Office of the Regional Inspector General for Audit, Nairobi (RIG/A/N) made a financial and compliance audit to determine if the MOA had an adequate financial system to handle the flow of A.I.D. assistance funds.

The audit was conducted during April and May 1988 at USAID and Government of Malawi offices in Lilongwe, Malawi. The audit focussed on the cost reimbursement elements of the Malawi Agricultural Research and Extension Project (612-0215), the Malawi Agricultural Research Project (612-0202), and the Malawi Fertilizer Subsidy Removal Project (612-0225). This involved obligations of about \$4.1 million of the projects' combined obligations of \$24.9 million. The audit staff interviewed USAID officials and examined USAID files and accounting records pertaining to the projects. The audit staff also interviewed MOA officials and inspected selected MOA records to determine the adequacy of the MOA's donor related financial system. The review of internal controls and compliance was limited to the finding reported. The audit was made in accordance with generally accepted government auditing standards.

Results of Audit

The MOA's donor related accounting systems were inadequate to obtain timely and accurate reimbursement from A.I.D.. The MOA was unable to file some claims, filed some claims with questionable underlying support, and filed some claims late and against the wrong donor. To correct this situation, the report recommends that the Mission require additional support for MOA claims and contract with an independent certified public accounting firm to identify needed MOA financial system improvements. Failing the needed improvements, the Mission should structure assistance to avoid MOA cost reimbursements.

MOA Was Unable to File Reliable Claims

A.I.D.'s Handbook 13 required A.I.D. recipient organizations to have adequate financial systems to handle the flow of assistance funds. However, the MOA's systems were inadequate. Thus, the MOA was unable to file some claims, filed some claims with questionable underlying support, and filed some claims late and against the wrong donors. These problems occurred because insufficient attention was devoted during project design to assessing the MOA's donor related financial systems and correcting deficiencies. The result was USAID/Malawi had paid about \$410,132 in claims which had questionable support in MOA files. Further, about \$3.7 million in USAID/Malawi obligations were unlikely to be liquidated in a timely manner, and if such obligations were liquidated by future claims, the claims might not be accurate.

Discussion - A.I.D. Handbook 13 described an adequate financial management system for recipients as one which provided: (i) Accounting records supported by documentation that at a minimum identifies, segregates, accumulates and records all costs incurred under a grant, (ii) procedures for determining the reasonableness, allowability and allocability of costs in accordance with the terms of the grant, and (iii) records that identify the application of funds for A.I.D. sponsored activities.

To ensure these standards can be met by aid recipient organizations, A.I.D. Handbook 3 required A.I.D. project papers to include assessments of the recipient's financial management systems. The assessment should determine if the recipient's financial management system will be capable of managing the project funds. If doubt existed about the financial management capability of the recipient organization, the Handbook urged a detailed survey of the financial information and control system.

USAID/Malawi's grants to the MOA required the use of project implementation letters. The letters restricted the MOA's use of funds to activities authorized in the letters, and set forth the documentation USAID/Malawi required before it would reimburse the MOA's local costs. Since the financial management requirements were an important part of the system for providing grant funds to the MOA, the MOA's ability to take these requirements into account should have been an important aspect of its donor related accounting system.

However, the MOA's financial system was not designed to take the A.I.D. financial management requirements into account or to adequately identify the costs reimbursable under the grants. For certain project areas, such as the research and extension project's in-country training, no claims had been filed even though activities were underway for about a year. In another area, the Fertilizer Demonstration Fund, the audit disclosed that the claims were filed late and the claims' supporting summary statements of expenditure may not have had adequate paid vouchers and receipts in MOA files as underlying support. Thus, the MOA's donor related financial management systems were not functioning adequately.

Claims were filed late or not at all because the MOA did not adequately provide for separately accumulating costs pertaining to A.I.D. assistance or to regularly making claims for those costs. For example, vouchers and receipts pertaining to A.I.D. projects were not filed separately, periodically listed, or reviewed as to correct donor attributions. Thus, the audit disclosed an absence of specific procedures and a clear document trail to enable the MOA to file accurate claims in a timely manner.

An additional concern was that the few claims which had been filed had questionable accuracy and support. The donor related accounting systems had inadequate internal accuracy checks and could not detect duplicate claims. Thus, any claims and their supporting summary statements of expenditure submitted to A.I.D. under the existing MOA system might not have correctly reflected the actual MOA costs.

Although USAID/Malawi implemented its MOA related projects by means of project implementation letters, the audit disclosed that the MOA was unable to take the A.I.D. financial management requirements into account when making claims. This inability of the MOA to implement required financial management procedures probably resulted in the MOA claiming expenses against the World Bank projects which should have been properly claimed against A.I.D..

The audit found no evidence that the MOA's financial system weaknesses would be corrected in the near future. The situation in fact could be expected to worsen because some key accountants with important donor related financial management duties had been transferred to other Ministries.

The problems found during the audit were caused by insufficient attention to the grant recipient's financial management capacity during the projects' design phases. The research and extension project paper, for example, noted that the MOA's financial management capacity to handle donors' funds needed strengthening. The matter was handled in the project paper by a statement that the World Bank would apply technical assistance to the problem areas. The World Bank had two projects complementary to the A.I.D. project. The auditors could find no additional information about any assessment of the problem by the project designers, even though A.I.D. Handbook 3 urged a detailed survey of the financial system if doubt existed about the MOA's financial management capacity.

The World Bank had in fact supplied some technical assistance to the MOA. However, the auditors' interviews with a local World Bank representative and the current World Bank technical advisor disclosed that nothing had been done about the problem areas. Rather, the technical advisor was working to strengthen the MOA's budgeting system.

Mission staff pointed out that cooperation with other donors is an important aspect of A.I.D. operations, and consequently the decision to rely on the World Bank for assistance was reasonable. The Mission conceded, however, that the Mission erred by not following up during project implementation to ensure World Bank action was taken.

USAID/Malawi had obligated about \$4.1 million under the research and extension project and two other MOA related projects which were to be paid to MOA under the cost reimbursement method. Of this amount USAID/Malawi had paid \$410,132 in claims. The underlying support for the statements of expenditure related to those claims should be questioned, based on the auditors' assessment of the MOA's financial systems. The remaining \$3.7 million in USAID/Malawi unliquidated obligated funds were unlikely to be liquidated in a timely manner. Further, any claims submitted would warrant questioning, based on the unreliability of existing systems.

Because of the foregoing situation, an audit by an independent certified public accounting firm will be needed to review past claims and to identify required corrective action. Without such an audit, the RIG/A/N auditors had little reason to believe future MOA claims for local costs would be reliable. If the needed improvements cannot be made, USAID/Malawi should structure assistance to avoid MOA local costs reimbursements.

Recommendation No. 1

We recommend that the Director, USAID/Malawi

- (a) suspend direct reimbursement of local costs for Ministry of Agriculture related projects which submit only certified statements of expenditure, and in the future require detailed support, such as receipts and paid vouchers, before paying such claims, and
- (b) contract with an independent certified public accounting firm to review the support for Ministry local costs paid under past claims and also to review the Ministry's donor related accounting systems in order to recommend improvements which the Ministry agrees to adopt; or, if the Mission Controller determines that the implementation of needed improvements will not be forthcoming, reprogram funds within each project to preclude the need for local costs claims from the MOA or deobligate/reobligate to other projects.

USAID/Malawi agreed with the report's finding and recommendation. In response to the audit the Mission had already issued a project implementation letter requiring the MOA to provide receipts and paid vouchers to support their reimbursement claims. The Mission had also begun the process of contracting with an independent certified public accounting firm to review past local cost expenditures and the MOA's donor related accounting systems.

The Office of the Inspector General considers recommendation No. 1a closed. Recommendation No. 1b is resolved and will be closed upon completion of the Mission's planned actions.

ACTION: AID-3 INFO: ECON RIO

Appendix 1

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DE RUEHLG #3432 1790904
ZNR UUUUU ZZH
O 270902Z JUN 88
FM AMEMBASSY LILONGWE
TO AMEMBASSY NAIROBI IMMEDIATE 5634
BT
UNCLAS LILONGWE 03432

27-JUN-88 TOR: 09:04
CN: 38395
CHRG: AID
DIST: AID
ADD:

AIDAC

FOR A/RIG/A/N CONNER
FROM ACTING MISSION DIRECTOR SHORTLIDGE

E.O. 12356: N/A

SUBJECT: AUDITS OF MARE PROJECT AND FLOW OF A.I.D.
ASSISTANCE FUNDS THROUGH THE MOA

REF: THABET/HICKS MEMOS DATED 6/9/88

MISSION COMMENTS ON DRAFT REPORTS ON SUBJECT AUDITS AS
FOLLOWS:

1. FLOW OF A.I.D. ASSISTANCE FUNDS TO MOA:

(A) CORRECT THE DATES IN SECOND SENTENCE OF PARAGRAPH
AUDIT OBJECTIVES AND SCOPE TO READ QUOTE APRIL AND MAY,
1988 UNQUOTE INSTEAD OF QUOTE APRIL AND MAY 1987 UNQUOTE.

(B) MISSION GENERALLY AGREES WITH AUDIT FINDINGS AND
HAVE TAKEN FOLLOWING ACTIONS AS RECOMMENDED:

- ISSUED A PIL NO 15 REQUIRING MOA TO PROVIDE RECEIPTS
AND PAID VOUCHERS TO SUPPORT THEIR REIMBURSEMENT CLAIMS.

- A PIO/T IS BEING DRAFTED PER PROGRAM DISK PROVIDED BY
RIG/N FOR ENTERING INTO A CONTRACT WITH INDEPENDENT CPA
TO REVIEW THE PAST LOCAL COSTS EXPENDITURES AND MOA'S
DONOR RELATED ACCOUNTING SYSTEMS.

INSPECTOR GENERAL'S NOTE

The material deleted here refers to another audit report
covering the Malawi Agricultural Research and Extension
(MARE) Project.

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REPORT DISTRIBUTION

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AA/M	2
M/FM/ASD	2
SAA/S&T (For AGR)	1
PPC/CDIE	3
M/SER/MO	1
IG	1
DIG	1
IG/PPO	2
IG/LC	1
IG/ADM/C&R	12
AIG/I	1
RIG/I/N	1
IG/PSA	1
RIG/A/C	1
RIG/A/D	1
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