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Audit of the Gambia's Economic Policy Reform Program Project Nos. 635-0228 and 635-0231

Audit Report No. 7-635-91-03
December 19, 1990

AGENCY FOR INTERNATIONAL DEVELOPMENT
Office of the Regional Inspector General for West Africa

December 19, 1990

MEMORANDUM

TO: Jimmie M. Stone, Representative, OAR/Banjul

FROM: Paul E. Armstrong, RIG/A/D

SUBJECT: Audit of the Gambia's Economic Policy Reform Program (Project Nos. 635-0228 and 635-0231)

Enclosed are five copies of the subject report. In preparing this report, we reviewed your comments on the draft report and included them herein as Appendix II. Based on your comments, the report recommendation is considered resolved and can be closed upon receipt of requested documentation. Please provide this documentation within 30 days. We appreciate the cooperation and courtesies extended to our staff during the audit.

Background

The Gambia's Economic Policy Reform Program was authorized by A.I.D. in September 1987 for a three-year period. A.I.D. was to provide cash transfers of $6 million (Project No. 635-0228) and technical assistance totaling $850,000 (Project No. 635-0231) to assist the Government of the Gambia in implementing, monitoring, and evaluating economic policy reforms. However, as of July 1990, only $4 million in cash transfers had been released and $52,000 in technical assistance had been spent. The final $2 million cash transfer was released in August 1990 subsequent to the completion of the audit.

The purpose of the program as originally designed was to assist the host government to establish financial policies and institute reforms which would give Gambia entrepreneurs greater and more equitable access to markets. This would be done by:

- eliminating less-than-market rate of interest on government loans;
- developing and implementing lending policies for agricultural credit and development loans at market rates;
- eliminating preferential access to official lines of credit; and
- remunerating all buyers of agricultural products without discrimination as to whether they are public or private.

The host government Ministry of Finance and Trade was responsible for developing and executing the reforms, and the Office of the A.I.D. Representative, Banjul (OAR/Banjul) was responsible for monitoring project implementation.

A.I.D.'s cash transfers were to be made in three tranches of $2 million each, and to be used by the host government to repay debts owed to multilateral, bilateral, and commercial lenders. The $4 million disbursed by A.I.D. by the time of the audit were used by the Gambia to repay debts to the International Monetary Fund.

During the course of the program, however, the purpose of the technical assistance component (Project No. 635-0231) was modified and the project completion date extended to September 1992. The original purpose was to assist and advise the host government in carrying out credit-related policy reforms and to monitor implementation of these reforms. However, by 1990, the reforms required for the release of program cash transfers had already been initiated without technical assistance, and monitoring responsibilities had been transferred to another A.I.D. project. Consequently, A.I.D. changed the focus of the technical assistance component--and increased funding to $1.65 million--to emphasize reviving and ultimately privatizing the Gambian Commercial and Development Bank (GCDB), a host government-owned bank which was having severe financial problems because of past lending policies. The GCDB had in the past made numerous loans to government officials and institutions at preferential rates, yielded to political pressures by appointing unqualified individuals to key positions, had not established sound credit policies or procedures, and did not pursue collections of delinquent loans.

At the time of the audit the GCDB was essentially bankrupt. However, a World Bank study issued in June 1988--and agreed to by both USAID and the host government--recommended appointing an expatriate Managing Director for a four-year term and a team of expatriate banking experts in order to put the GCDB on a sound financial and managerial footing. The salaries of the expatriate officials were to be jointly financed by the World Bank and A.I.D., with the World Bank financing the expatriate Managing Director (put in place in February 1990) and A.I.D. financing three expatriate banking experts, as well as various other costs under the modified technical assistance component (see Appendix V). But as of July 1990 no banking experts had been brought on board--technical assistance being delayed because of a dispute with the host government--and of the $1.075 million obligated only $52,000 has been spent.

Audit Objective

We audited OAR/Banjul's Gambian Economic Policy Reform Program to answer the following audit objective:

- Has the Program been successful in achieving its objectives? Specifically, has the host government used cash transfers as required and has it carried out required policy reforms and has the Mission been able to provide an effective program of technical assistance?

In answering this objective, we identified issues inhibiting the scheduled disbursement of both cash transfer and technical assistance funds and reviewed whether planned policy reforms for each of the cash transfers had been initiated as required. We verified that dollar cash transfers were used to repay external debt as intended and reviewed the use and effectiveness of technical assistance funds.

These tests were sufficient to provide reasonable--but not absolute--assurance of detecting abuse or illegal acts. However, because of limited time and resources, we did not continue testing when we found that, for the items tested, OAR/Banjul (or the host government) followed A.I.D. procedures and complied with legal requirements. Therefore, we limited our conclusions concerning positive findings to the items actually tested. When we found problem areas, we performed additional work to:

- conclusively determine whether OAR/Banjul or the host government was complying with an agreed-upon condition;
- identify the cause and effect of the problem; and
- make recommendations to address the problem.

Our discussion of the scope and methodology for this audit is in Appendix I and our reports on internal controls and compliance are in Appendices III and IV respectively.

Audit Finding

Has the program been successful in achieving its objectives?

The purpose of the audit was to ascertain whether the host government used cash transfers as required, whether it had carried out the policy reforms for the release of these cash transfers, and to what extent the Mission had been able to provide an associated program of technical assistance. The auditors concluded that OAR/Banjul had followed A.I.D. procedures in disbursing the first two cash transfers totaling $4 million, and that the host government had used all dollar funds as indicated to repay International Monetary Fund debt. The third and final cash transfer was made subsequent to the audit. We, nevertheless, concluded that at the time of the audit, the host government had already initiated actions required for release of all three cash transfers. For example, the host government had clearly issued guidance prohibiting the provision of government loans at less than market rates--a reversal of a long-standing practice of providing subsidized credit to parastatals and certain well-connected individuals. At the time of the audit we saw no evidence that less-than-market-rate loans were being issued. (On the other hand, we do recognize that some reforms specified under the program, such as stopping preferential access to credit, had in fact been undertaken by the host government even prior to GEPRP program approval--presumably, as noted in a recent impact evaluation, as part of a broader World Bank program).

Nevertheless, the Mission had not been able to provide an effective program of technical assistance, and hence the auditors concluded that the modified objectives of the associated technical assistance project for restructuring the Gambian Commercial and Development Bank (GCDB) were not being achieved. This situation arose because the host government had reneged on one of the key provisions for restructuring the GCDB--namely, the provision that the expatriate Managing Director funded by the World Bank, had the authority to select and groom a Gambian successor. Unfortunately, the Mission had no easily available remedy to enforce compliance with what, in effect, was a recommendation of a World Bank study agreed to by the host government. Instead, in opposition to this agreement, the host government had itself installed in the GCDB a political appointee with little banking experience as acting chief executive. As a result, A.I.D. technical assistance was put on hold and at the time of the audit successful restructuring of the GCDB seemed unlikely.

Several efforts were undertaken to remedy this situation. At the time of the audit, the Mission was withholding the final $2 million cash transfer in order to persuade the host government to allow the expatriate Managing Director to exercise his agreed-upon functions, and to show its displeasure, the World Bank was threatening to cut off all funding to the Gambia. In addition, RIG/A/Dakar in a Record of Audit Finding issued on July 20, 1990 recommended that all program funds be deobligated unless the expatriate Managing Director was permitted to exercise his authority to name a qualified Gambian to work with him in carrying out the GCDB restructuring.

The Technical Assistance Project Purpose Is Not Being Achieved

The purpose of the Gambia's Economic Policy Reform Program as a whole was to institute policy reforms which would encourage and promote greater and more equitable access to markets for private entrepreneurs. While the Mission was successful in encouraging host government implementation of several reform-related actions required for the disbursement of the three cash transfers, host government actions under the associated technical assistance project were inconsistent with the intent of these reforms and potentially destructive to the program purpose of providing equitable access to credit. This condition was caused by actions taken by the host government which were counter to the understanding reached with A.I.D. and the World Bank on how the GCDB restructuring was to be managed under the technical assistance project--and by the lack of a clearly stated definition of Managing Director authority, resulting in A.I.D.'s inability to enforce the terms of this understanding.

As a result, the Mission originally withheld disbursement of the final cash transfer of $2 million, and almost $1.65 million in technical assistance funds authorized for technical assistance have not been used.

In addition, the World Bank, the GCDB and the Mission have been thrown into a state of turmoil. The World Bank stated that it would not be a party to another bank failure in Africa and threatened to suspend all its operations in the Gambia. Similarly, GCDB operations were in limbo, with the expatriate Managing Director struggling to introduce changes without the assistance of the three expatriate banking experts who were to be funded by A.I.D. The Managing Director was also frustrated by the actions of the Gambian political appointee who was installed by the host government. This appointee openly challenged the authority of the expatriate Managing Director, refused to submit to training, and was actively undermining reforms already underway. In consequence, GCDB employees were sometimes ambivalent or hostile to reforms being carried out in the GCDB, preferring to wait until the Gambian appointee would assume full responsibility.

Subsequent Events

Subsequent to the completion of audit fieldwork, the Mission was told by legal counsel that withholding of the $2 million final cash transfer was not justified, as specified actions required for its release had been technically achieved. The Mission accordingly requested the release of the $2 million on August 22, 1990.

RIG/A/D, on the other hand, believed and continues to believe, that there are provisions in the program grant agreement itself which would have justified A.I.D.'s actions to withhold the final cash transfer--as well as the associated technical assistance funds: namely, termination of the program and deobligation of the unused funds. Article VII, Section 7.1 of the agreement allows either party to terminate the grant agreement by giving the other party thirty days written notice. Also section 7.2 C of the same Article states that A.I.D. may suspend or cancel this agreement if at any time "...an event occurs which A.I.D. determines to be an extraordinary situation that makes it improbable either that the purpose of this grant will be attained or that the grantee will be able to perform its obligations under this agreement."

Accordingly, we believe that the above provisions would fully justify A.I.D.'s actions to terminate the technical assistance project because under the conditions existing at the time of the audit, it was extremely unlikely that the overall project purpose would be realized. More specifically, not only was the immediate objective of putting the GCDB on sound financial and managerial footing not likely to be achieved, but the broader policy reform of more equitable access to credit was likely to be compromised.

Other events subsequent to the completion of audit fieldwork have even further complicated the situation. We learned at the end of August 1990, that the host government under pressure from A.I.D. and the World Bank, had ultimately removed from the GCDB the political appointee whose presence had caused much of the turmoil. However, the expatriate Managing Director had by that time already submitted his resignation, and it was not clear whether he could be persuaded to resume his duties.

In addition, with regard to the three banking experts who were to be recruited to assist the expatriate Managing Director, the future was just as unclear. Considering that it would take months to recruit the three A.I.D.-funded banking experts even if the expatriate Managing Director should decide to stay on, we questioned whether A.I.D. provision of additional technical assistance in the current demoralized environment would have been of much value. We therefore recommended that the Mission terminate the project and deobligate all unused funds unless the expatriate Managing Director resumed his duties with the full support of the host government, and prospects for success were promising.

Recommendation No. 1: We recommend that OAR/Banjul terminate all technical assistance under Project No. 635-0231 and deobligate the remaining funding (approximately $1.023 million) unless the Mission provides convincing evidence that the Government of the Gambia has accorded the expatriate Managing Director full authority to manage the project as agreed.

Mission Comments and Our Evaluation

OAR/Banjul generally agreed with the report's findings but noted that a number of major changes had taken place since the audit. Specifically, the President of the Gambia had removed the political appointee from the GCDB, the World Bank financed Managing Director had withdrawn his letter of resignation, first steps were being taken to have the GCDB privatized, and the host government had purportedly given the Managing Director full authority to manage the bank according to sound commercial practices. Accordingly, OAR/Banjul requested that the recommendation be modified to reflect these developments.

We believe that OAR/Banjul has provided convincing evidence that the restructuring of the GCDB now has a chance to succeed and hence have modified the recommendation. Nevertheless, prior to closing the recommendation, we would like to review documentation by which the host government has granted the expatriate Managing Director the authority to manage the GCDB restructuring. We believe that the authority of the Managing Director should be clearly set forth prior to A.I.D. financing any additional technical assistance. We believe furthermore that the lack of a clearly stated definition of Managing Director powers, explicitly agreed upon by all parties, led to the original impasse. Recomendation No. 1 is therefore considered resolved and can be closed upon our review of the requested documentation.

SCOPE AND METHODOLOGY

Scope

We audited the Gambia's Economic Policy Reform Program (GEPRP) as well as its complementary program of technical assistance, in accordance with generally accepted government auditing standards. We conducted the audit from July 16 through August 1, 1990 in the offices of the OAR/Banjul, the host government's Ministry of Finance and Trade, and the Gambian Commercial and Development Bank.

Methodology

To accomplish the audit objective, we identified issues inhibiting scheduled disbursement of cash transfer funds and/or implementation of the host government's reform program; we verified the use of A.I.D. cash transfers to repay loans to other external donors and ascertained if applicable guidelines were followed, and reviewed the use of technical assistance funds. We examined the project paper, grant agreements, project implementation letters and reports on project implementation, evaluations, contractor performance and financial status.

We traced the movement of cash transfer funds from the Gambia's Federal Reserve Bank special account to banks in Europe for the payment of International Monetary Fund debt. We also reviewed conditions precedent and special covenants contained in the Project Grant Agreement, verified that required documentation relative to fulfilling these conditions and covenenants had been provided by the host government as required, and interviewed USAID and World Bank personnel, host country officials and Gambian Commercial and Development Bank staff to ascertain if said conditions and covenants had in fact been carried out.

Our audit included a review of the Mission's 1989 vulnerability assessment, particularly with regard to controls over non-project activities. We did not, however, examine the internal controls over the technical assistance expenditures of the GEPRP because at the time of the audit (1) only $52,000 out of the $1.075 million obligated had been spent, and it was therefore possible to perform direct substantive testing for allowability and reasonableness on the relatively small amounts expended, and (2) no technical assistance contractor was yet on site.

ACTION: RIG INFO: AMB DCM

APPENDIX II

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AIDAC

FOR RIG/A/D, PAUL E. ARMSTRONG

E.O. 12356 N/A
SUBJECT: DRAFT AUDIT REPORT OF THE GAMBIA'S ECONOMIC POLICY REFORM PROGRAM (PROJECT NOS. 635-0228 AND 635-0231)

REF: ARMSTRONG/STONE MEMORANDUM DATED OCTOBER 10, 1990

1. THE PRESIDENT OF THE GAMBIA REMOVED THE ACTING MANAGING DIRECTOR DESIGNATE FROM THE GCDB AND ELIMINATED THE LINE POSITION. THREE MEMBERS, INCLUDING THE CHAIRMAN, WERE REMOVED FROM THE BANK'S BOARD OF DIRECTORS. THE WORLD BANK FNANCED MANAGING DIRECTOR WITHDREW HIS LETTER OF RESIGNATION. LEGISLATION WAS ENACTED WHICH REORGANIZED THE BANK AS A LIMITED LIABILITY COMPANY. (FYI. THIS IS A NECESSARY STEP IN ORDER TO HAVE THE BANK PRIVATIZED. END FYI).

2. THE WORLD BANK, THE IMF, AND USAID ARE IN AGREEMENT THAT THE GOTG HAS GIVEN THE GCDB MANAGING DIRECTOR THE AUTHORITY TO OPERATE ACCORDING TO SOUND COMMERCIAL PRACTICES. OUR TECHNICAL ASSISTANCE IS REQUIRED TO SUPPORT HIS WORK AND TRAIN TOP MANAGEMENT. THE GOTG HAS SIGNED A POLICY FRAMEWORK PAPER WITH THE IMF/WORLD BANK COMMITTING ITSELF TO PRIVATIZE THE BANK. USAID SEES A REHABILITATED GCDB AS A CRUCIAL ELEMENT IN ESTABLISHING A SOUND AND COMPETITIVE BANKING SYSTEM IN THE GAMBIA.

3. WE BELIEVE FOR THESE REASONS THAT THE ONGOING RESTRUCTURING OF THE GCDB IS LIKELY TO SUCCEED. THEREFORE, USAID/BANJUL IS MOVING FORWARD WITH THE RECRUITMENT OF TECHNICAL ASSISTANCE. WE WOULD LIKE TO SEE AUDT RECOMMENDATION NO. 1 MODIFIED TO REFLECT THE ABOVE, RECENT DEVELOPMENTS. COFFMAN
BT
#2993

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REPORT ON INTERNAL CONTROLS

We have audited OAR/Banjul's control over the dollar cash transfers for the Gambia's Economic Policy Reform Program for the period September 10, 1987 through June 30, 1990 and have issued our report thereon dated December 19, 1990.

We conducted our audit in accordance with generally accepted government auditing standards, which require that we plan and perform the audit to fairly, objectively, and reliably answer the objectives of the audit. Those standards also require that we:

- assess the applicable internal controls when necessary to satisfy the audit objectives; and

- report on the controls assessed, the scope of our work, and any significant weaknesses found during the audit.

In planning and performing our audit, we considered A.I.D.'s internal control structure to determine our auditing procedures in order to answer the audit objectives and not to provide assurance on the internal control structure.

The management of A.I.D. including OAR/Banjul, is responsible for establishing and maintaining adequate internal controls. Recognizing the need to re-emphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Manager's Financial Integrity Act (the Integrity Act) in September 1982. This Act, which amends the Accounting and Auditing Act of 1950, makes the heads of executive agencies and other managers as delegated legally responsible for establishing and maintaining adequate internal controls. Also, the General Accounting Office (GAO) has issued "Standards of Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining such controls.

In response to the Integrity Act, the Office of Management and Budget has issued guidelines for the "Evaluation and Improvement of Reporting on Internal Control Systems in the Federal Government". According to these guidelines, management is required to assess expected benefits versus related costs of internal control policies and procedures. The objectives of internal control policies and procedures for foreign assistance programs are to provide management with reasonable--but not absolute--assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports.

Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether a system will work in the future is risky because (1) changes in conditions may require additional procedures or (2) the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purposes of this report, we have classified significant internal control policies and procedures applicable to each of the audit objectives by categories. For each category, we obtained an understanding of relevant policies and procedures and determined whether they have been placed in operation--and we assessed control risk. In doing this work, we noted no problems that we consider reportable under standards established by the Comptroller General of the United States. Reportable conditions are those relating to significant deficiencies in the design or operation of the internal control structure which we become aware of and which, in our judgment, could adversely affect OAR/Banjul's ability to assure that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports.

Audit Objective

This objective relates to the controls over cash transfers and technical assistance funding. In planning and performing our audit of the cash transfers and technical assistance funding, we considered the applicable internal control policies and procedures cited in A.I.D. guidance cables for cash transfer programs, as well as applicable A.I.D. Handbooks on project management and funds control. For the purposes of this report, we have classified the relevant policies and procedures into the following categories: meeting of conditions precedent and the release of dollar cash transfers to the special account, tracking dollars and monitoring their use, and fund control procedures with regard to project amendment. As noted in Appendix I, we did not, however, review internal controls over the small amount of technical assistance funds actually spent. In our review we noted no reportable conditions related to the controls over cash transfers or technical assistance funding.

A material weakness is a reportable condition in which the design or operation of the specified internal control elements does not reduce to a relatively low level of risk that errors or irregularities in amounts that would be material in relation to the financial reports on project funds being audited 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 controls would not necessarily disclose all matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. Our limited review of internal controls revealed no such material weaknesses.

REPORT ON COMPLIANCE

We have audited the Gambia's Economic Policy Reform Program for the period September 10, 1987 through June 30, 1990 and have issued our report thereon dated December 19, 1990.

We conducted our audit in accordance with generally accepted government auditing standards, which require that we plan and perform the audit to fairly, objectively, and reliably answer the audit objectives. Those standards also require that we:

- assess compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives (which includes designing the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives); and

- report all significant instances of noncompliance and abuse and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grants and binding policies and procedures governing entity conduct. Noncompliance with internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition and is included in our report on internal controls. Abuse is furnishing excessive services to beneficiaries or performing what may be considered improper practices, which do not involve compliance with laws and regulations.

Compliance with laws, regulations, contracts, and grants applicable to the project is the overall responsibility of OAR/Banjul's management. As part of fairly, objectively, and reliably answering the audit objective, we performed tests of OAR/Banjul and host government compliance with certain provisions of Federal laws and regulations, contracts and grants. However, our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests of compliance showed that the host government had not taken actions agreed upon with A.I.D. and the World Bank (and specified in World Bank study dated June 1988) with regard to the restructuring of the Gambian Commercial and Development Bank.

Except as described, the results of our tests of compliance indicate that, with respect to the items tested, OAR/Banjul and the Government of the Gambia complied, in all significant respects, with the provisions referred to in the fourth paragraph of this report.

With respect to items not tested, nothing came to our attention that caused us to believe that OAR/Banjul, contractors, and the Government of the Gambia had not complied, in all significant respects, with those provisions.

BUDGET FOR TECHNICAL ASSISTANCE EXPENDITURES

Under the Gambia's Economic Policy Reform Program
Project No. 635-0231
As of June 30, 1990

	(U.S. $)
Development of baseline data	39,665
Miscellaneous contact services	12,697
Audit and evaluations	40,000
Three banking experts and related costs	1,557,638
	1,650,000

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