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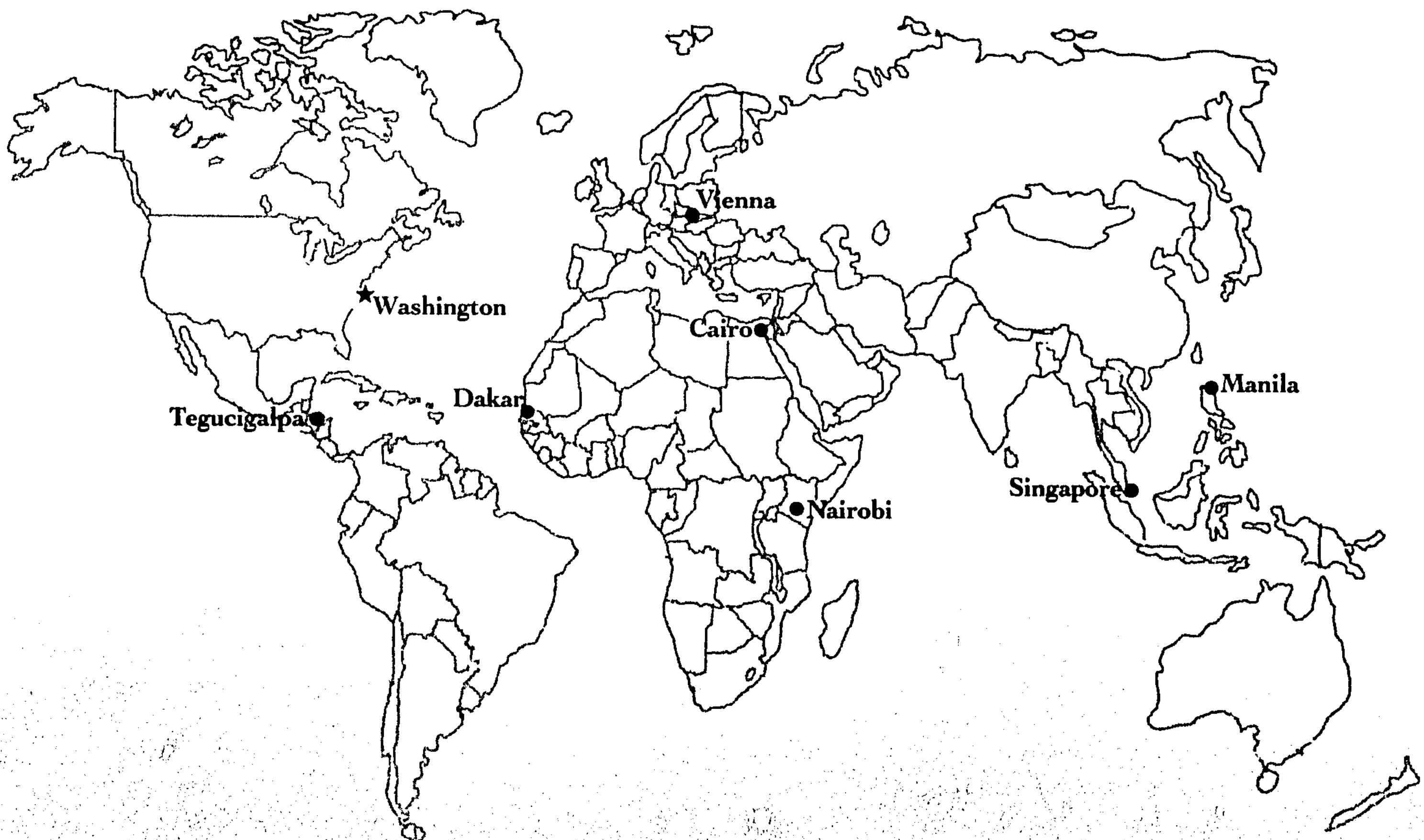
Regional Inspector General for Audit
Nairobi, Kenya

Audit of The Malawi Enterprise Development Program

Report No. 3-612-92-14
July 31, 1992



INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

UNITED STATES OF AMERICA

AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL FOR AUDIT

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July 31, 1992

MEMORANDUM

TO : Carol A. Peasley, Mission Director, USAID/Malawi

FROM : Joseph Farinella, Acting RIG/A/Nairobi Joseph Farinella

SUBJECT: Audit of the Malawi Enterprise Development Program, Program No. 612-0233

Enclosed are five copies of our audit report on the Malawi Enterprise Development Program, Report No. 3-612-92-14.

We reviewed your comments on the draft report, made wording changes as appropriate, and included your response as an appendix to this report. Based on your comments and actions taken by the Mission, Recommendation 1.1 is closed, Recommendations 2.1, 2.2 and 3.2 are resolved and Recommendations 1.2 and 3.1 are unresolved. Recommendations will be resolved and closed when appropriate actions are completed as described on page 23 of the report. Please advise me within 30 days of any actions taken or planned to implement the recommendations.

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

EXECUTIVE SUMMARY

Background

The purpose of the Malawi Enterprise Development Program (MED) is to stimulate the growth of the private industrial and commercial sectors of the Malawian economy and to enable, in the long run, an increase in employment and incomes from a strong and dynamic private sector. This is to be accomplished by supporting policies directed at reducing economic, institutional and fiscal distortions which inhibit private sector development. The program is comprised of both project and nonproject assistance (cash transfers) at a cost to USAID of $36.6 million. The Government of Malawi is also required to generate the local currency equivalent of $35 million -- resulting from the program's cash transfers -- to be used primarily to fund activities in its budgets that relate to the program's objectives. (See page 1.)

The nonproject assistance consists of a $35 million cash grant to be disbursed to the Government of Malawi in three tranches upon fulfillment of agreed upon policy and institutional reforms. These reforms focus on: (1) liberalization of trade and industrial policies and flexible exchange rate management; (2) small and medium scale enterprise development; and (3) Government of Malawi fiscal policies. (See page 1.)

MED project assistance consists of $1.6 million to provide technical assistance and training for small and medium-size businesses using the International Executive Service Corps and to fund a limited number of program-related technical studies and evaluations. (See page 1.)

The six-year MED Program was initiated on August 29, 1988, and as of September 17, 1991, all of the $36.6 million in USAID funds had been obligated and $20 million in cash transfers had been disbursed. According to a financial report provided to us by USAID/Malawi, only $40,734 of the project assistance had been disbursed as of September 17, 1991. However, an additional payment of $46,700 to the technical assistance grantee had been authorized but had not yet appeared in the financial reports. (See page 2.)

Audit Objectives

We audited the Malawi Enterprise Development Program in accordance with generally accepted government auditing standards. (See page 2 and Appendix I.) Our field work was conducted from September through October 1991 and additional analytical work was performed from October 1991 to March 1992 to answer the following questions:

1. Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in obligating and disbursing funds for cash transfers to the Government of Malawi under the Malawi Enterprise Development Program? (See page 5.)

2. Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in monitoring the generation, deposit and use of program local currencies? (See page 8.)

3. Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in monitoring the performance of the program's technical assistance grantee and in obligating and spending funds for these activities? (See page 12.)

Summary of Audit

The audit found that USAID/Malawi followed applicable grant provisions and agency policies and procedures in obligating and disbursing funds for cash transfers to the Government of Malawi ("the Government"). (See page 5.) In addition, USAID/Malawi followed grant provisions and agency policies and procedures in monitoring the generation and use of program local currencies. However, USAID/Malawi did not follow applicable agency policies and procedures in monitoring the depositing of program local currencies. USAID/Malawi's waiver of the A.I.D. policy preference for depositing local currency funds in an interest-bearing account was not supported by information provided by the Government and this requirement should be renegotiated with the Government. (See page 8.) The local currency equivalent of approximately $1 million in interest could have been earned between October 1988 and April 1991 if an interest-bearing account had been used. Using interest-bearing accounts could generate the local currency equivalent of $635,648 in interest over the remainder of this program and $465,165 in another program that recently started in Malawi. Also, USAID/Malawi did not follow applicable agency policies and procedures in monitoring the performance of the program's technical assistance grantee.

As a result, the project officer does not have sufficient information to determine whether program funds are being used effectively. We found that the grantee has provided services to parastatals and large firms in contradiction with the grant agreement. In addition, a payment of $46,700 to the grantee was not supported by complete cost information. (See page 12.)

Audit Findings

Cash Transfers to the Government of Malawi

USAID/Malawi followed grant provisions and agency policies in obligating and disbursing funds for cash transfers to the Government of Malawi under the Malawi Enterprise Development Program. (See page 5.)

MED Program Local Currency Generations

USAID/Malawi has followed applicable grant provisions and agency policies and procedures in monitoring the generation and use of program local currencies. However, USAID/Malawi has not followed applicable agency policies and procedures in depositing program local currencies. As discussed below, we believe USAID/Malawi's waiver of the A.I.D. policy preference for depositing program-generated local currency funds in an interest-bearing account was not supported by the information provided by the Government and that the issue of using such accounts should be reopened with the Government. (See page 8.)

Local Currency Funds Should be Placed in an Interest-Bearing Account

A.I.D guidance recommends that local currency generations be placed in interest-bearing accounts. USAID/Malawi waived this policy for the Malawi Enterprise Development Program, as allowed in the guidance, because of the Government of Malawi's claims that an interest-bearing account would undermine internationally-supported stabilization agreements. Our analysis of this information and discussions with a Ministry of Finance official disclosed that the justification for the waiver was not fully supported and we believe the issue of using an interest-bearing account for local currency generations should be reopened with the Government. These funds could have generated approximately $1 million in interest from

October 1988 through April 1991 and could generate $635,648 in interest over the remainder of the program. Requiring the use of an interest-bearing account for local currencies generated by another recently approved USAID/Malawi project could also generate $456,165 in interest. (See pages 8-11.)

Monitoring the Program's
Technical Assistance Grantee

USAID/Malawi followed applicable grant provisions and agency policies and procedures in obligating funds for the program's technical assistance grantee. However, USAID/Malawi did not follow agency policies and procedures in monitoring the performance of the technical assistance grantee and in the spending of funds for these activities. (See page 12.)

Improvements Needed in
Monitoring Grantee Performance

A.I.D. policy assigns primary responsibility for program monitoring to the program officer, which includes ensuring technical services financed with USAID funds are being utilized effectively. USAID/Malawi's technical assistance agreement with the International Executive Service Corps (IESC) specifies several reports and documents to be provided to USAID/Malawi for use in monitoring its performance. We found that most of these reports were not prepared or not sent to USAID/Malawi and that the Mission had not established a system of monitoring IESC's performance using these reports or an alternative method. Without an effective monitoring system USAID/Malawi was unaware of many of IESC's activities including the use of program funds to provide services to parastatals and large businesses contrary to the program's objectives and the grant agreement. (See pages 12-15.)

Payments to Grantee Should be
Supported by Complete Cost Information

A.I.D. policy states that program officers are to administratively approve all vouchers submitted for payment since the program officer is in a position to know or find out -- before payments are made -- if services have been performed pursuant to the contract or grant. We found that the one payment of $46,700 already made to IESC was administratively approved for payment although neither the IESC-Malawi country director nor the program officer could explain how the billing was computed or what services it covered. USAID/Malawi should determine the allowability of this payment and recover the amount if appropriate. It should further ensure that detailed supporting documentation is provided by IESC before approving any future payments. (See pages 16-17.)

Summary of Recommendations

The audit report contains three recommendations to the Director, USAID/Malawi to:

- negotiate with the Government the requirement to place local currency generations in an interest-bearing account for the MED Program and any other USAID/Malawi program (see page 9);

- establish a system of monitoring and controlling the activities and performance of the International Executive Service Corps and report to the Assistant Administrator the problem of monitoring technical assistance contractors and grantees as a material weakness in the next Federal Managers' Financial Integrity Act reporting cycle if this weakness is not corrected (see page 13); and

- determine the allowability of unsupported costs of $46,700 and obtain detailed financial and cost information before authorizing any additional payments of grant funds (see page 16).

Management Comments and Our Evaluation

USAID/Malawi reviewed the draft report and offered several comments but generally agreed with the findings. USAID/Malawi's comments were considered in preparing the final report. Recommendation 1.1 is closed, Recommendations 2.1 , 2.2 and 3.2 are resolved and Recommendations 1.2 and 3.1 are unresolved. (See page 23 and Appendix II.)

Office of the Inspector General

Office of the Inspector General
July 31, 1992

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<u>APPENDICES</u>

INTRODUCTION

Background

The purpose of the Malawi Enterprise Development Program (MED) is to stimulate the growth of the private industrial and commercial sectors of the Malawian economy and to enable, in the long run, an increase in employment and incomes from a strong and dynamic private sector. The program is designed to revitalize existing businesses and create new enterprises -- particularly small and medium scale enterprises -- by supporting policies directed at reducing economic, institutional, and fiscal distortions which inhibit private sector development.

The program's purpose is to be achieved through a combination of project and nonproject assistance (cash transfers) at a cost to USAID of $36.6 million. The Government of Malawi is also required to generate the local currency equivalent of $35 million -- resulting from the program's cash transfers -- to be used primarily to fund activities in its recurrent and development budgets that relate to the program's objectives.

The nonproject assistance consists of a $35 million cash grant to be disbursed to the Government of Malawi in three tranches upon fulfillment of agreed upon policy and institutional reforms. Some of these reforms overlap with the World Bank's industrial sector program -- the Industrial and Trade Policy Adjustment Credit (ITPAC) agreement -- and focus on the following areas:

(a) liberalization of trade and industrial policies and flexible exchange rate management;

(b) small and medium scale enterprise development; and

(c) Government of Malawi fiscal policies.

MED project assistance consists of $1.6 million to provide technical assistance and training for small and medium-size businesses using the International Executive Service Corps (IESC) and to fund a limited number of program-related technical studies and evaluations. IESC makes available to Malawi businesses the management skills, basic technologies and "know-how" of skilled volunteer executives (VEs) -- generally retired American business executives -- with the costs of the consultancy totally or partially paid for by USAID. The grant also specifies that IESC services are to be marketed toward private sector businesses with parastatal consultancies accepted only if the entity paid all of the costs of the consultancy. IESC operations in Malawi are managed by a country director who is stationed in the city of Blantyre where most of the consultancies have been performed. The IESC-Malawi grant agreement was signed December 1, 1989, and as of September 30, 1991, ten consultancies had been completed.

The six-year MED Program was initiated on August 29, 1988, and as of September 17, 1991, all of the $36.6 million in USAID funds had been obligated and $20 million in cash transfers had been disbursed. According to a financial report provided to us by USAID/Malawi, only $40,734 of the project assistance had actually been disbursed as of September 17, 1991. However, an additional payment of $46,700 to the technical assistance grantee had been authorized but had not yet appeared in the financial reports.[1]

Audit Objectives

The Office of the Regional Inspector General for Audit/Nairobi audited the Malawi Enterprise Development Program in accordance with generally accepted government auditing standards. This program was selected for audit because it involved important policy changes in Malawi's economy. Our field work was conducted from September through October 1991 and additional analytical work was performed from October 1991 to March 1992 to answer the following objectives:

1. Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in obligating and disbursing funds for cash transfers to the Government of Malawi under the Malawi Enterprise Development Program?

2. Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in monitoring the generation, deposit and use of program local currencies?

[1] As of September 17, 1991, IESC had completed ten consultancies with an estimated cost of $210,000 but had only submitted billings for $46,700.

3. Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in monitoring the performance of the program's technical assistance grantee and in obligating and spending funds for these activities?

In answering these audit objectives, we tested whether USAID/Malawi (1) followed applicable internal control procedures and (2) complied with certain provisions of regulations, policies, grants and contracts. Our tests were sufficient to provide reasonable --but not absolute -- assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. When we found problem areas, we:

- conclusively determined whether USAID/Malawi was following procedures or complying with legal requirements,

- identified the causes and effects of the problems, and

- made recommendations to correct the conditions and causes of the problems.

Appendix I contains a complete discussion of the scope and methodology for each objective.

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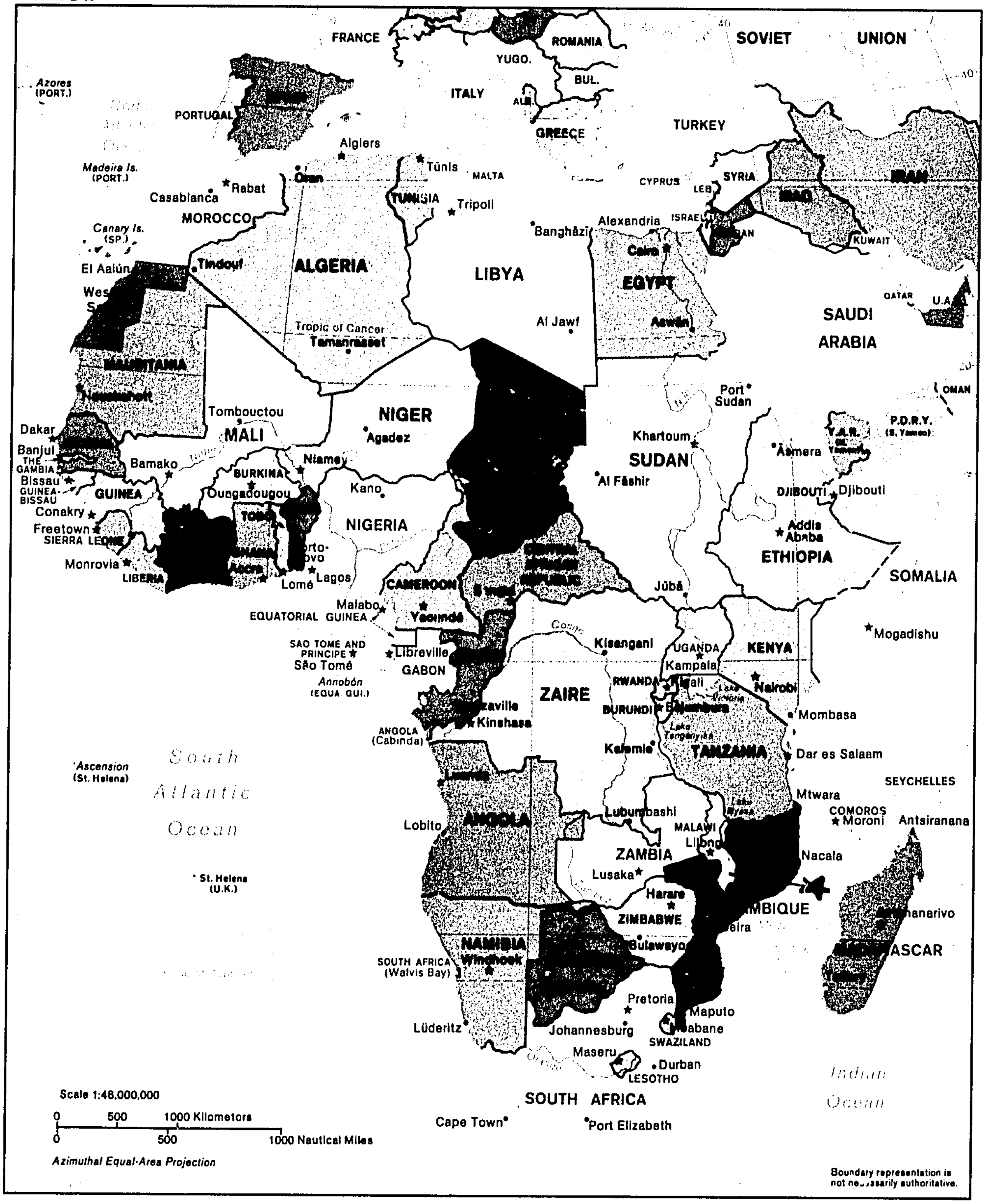

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REPORT OF AUDIT FINDINGS

Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in obligating and disbursing funds for cash transfers to the Government of Malawi under the Malawi Enterprise Development Program?

In our opinion, USAID/Malawi followed grant provisions and agency policies and procedures in obligating and disbursing funds for cash transfers to the Government of Malawi ("the Government") under the Malawi Enterprise Development Program (MED).

As of July 31, 1990, a total of $35 million in A.I.D. funds had been obligated for MED cash transfers to the Government. USAID/Malawi's MED grant agreement with the Government, signed on August 29, 1988, with its subsequent amendments is the obligating document for these cash transfers and contains the required obligating provisions as detailed in A.I.D. Handbook 4, Chapter 8, Paragraph 8E.

The MED grant agreement originally called for the $35 million in cash transfers to be disbursed in three tranches of $15 million, $10 million and $10 million with a set of conditions precedent for each tranche. Amendment No. 6 to the grant agreement, dated December 28, 1989, split the second tranche and its conditions precedent into two separate $5 million disbursements. As of September 30, 1991, $20 million in MED cash transfers had been disbursed to the Government -- $15 million for the first tranche and $5 million for half of the second tranche.

A.I.D. Handbook 4, Chapter 8 states that A.I.D. must have evidence that all conditions precedent, for disbursing funds under a cash transfer agreement, have been met and the date they were met before funds are released to the cooperating country.

The MED grant agreement and amendments to the agreement specified, in detail, changes in the Government's trade, industrial and fiscal policies that were required as conditions precedent before funds could be transferred to the Government. These conditions precedent were intended to stimulate the growth of the private industrial and commercial sectors of the Malawian economy. The conditions precedent for MED's first and second tranches in general parallel the conditions that were required for disbursement of other donor resources made available through the World Bank's industrial sector program -- the

Industrial and Trade Policy Adjustment Credit (ITPAC) agreement. Many of the conditions precedent for the first tranche had already been implemented by the time the MED grant agreement was signed in August 1988.

USAID/Malawi followed A.I.D. procedures to obtain evidence that the specified conditions precedent were met before cash transfers totalling $20 million were made to the Government in two tranches in September 1988 and December 1989. USAID/Malawi officials reviewed, analyzed, documented, and when possible, independently confirmed evidence which showed that the required policy changes had been made. These conditions precedent included:

- maintaining a flexible exchange rate policy for the twelve months preceding the cash transfer;

- adopting foreign exchange allocation liberalization of 75% of the 1984 base year's value of raw material and spare parts imports;

- revising the Industrial Development Act to permit a streamlining and rationalization of industrial licensing;

- reducing the ratio between the Government's budget deficit and the gross domestic product (GDP) in the fiscal year 1987/88 and 1988/89 budgets to a level less than that of the preceding year;

- reducing the number of items for which import and export licenses are required; and

- streamlining the foreign exchange approval and payment process.

The evidence gathered, analyzed and documented for the above conditions precedent included:

- a letter from the Ministry of Finance confirming that it had allowed the Malawi kwacha to float against a basket of seven currencies and devalued the kwacha by 15% in January 1988. As a result of these steps, the kwacha had declined in value against the U.S. dollar by 20% over the preceding 12 months;

- a listing from the Reserve Bank of Malawi of the raw materials and spare parts making up the 75% increase of liberalized imports that was effected on February 1 and August 8, 1988;

- a copy of the May 27, 1988 Act of Parliament amending the Industrial Development Act to permit a streamlining of industrial licensing;

- statistical information for fiscal years 1986/87, 1987/88 and 1988/89 showing a declining ratio between the budget deficit and the GDP for those years of 12.7%, 10.2%, and 6.6%, respectively;

- a listing from the Ministry of Finance detailing items for which import and export license requirements had been removed; principally construction materials and food imports; and

- statistical information showing that the foreign exchange approval processing time had been reduced 25% for non-liberalized imports and 67% for liberalized items. The foreign exchange payment processing time had been reduced from a month to only 3 days.

In compliance with A.I.D. Handbook 4 procedures, USAID/Malawi obtained this evidence and confirmed to AID/W that all conditions precedent were met. USAID/Malawi also supplied AID/W with other required documentation including the date the conditions precedent were met, the dollar amount to be disbursed, the bank address, account name and number to which the funds were to be sent.

As a result of the evidence gathered and the analyses performed by USAID/Malawi supporting that the required policy changes were made, we concluded that A.I.D. transferred $20 million in accordance with A.I.D. procedures.

In addition to the conditions precedent relating to policy reforms detailed above, the grant agreement also required the establishment of an interest-bearing special account for the deposit of all local currencies generated by the program. USAID/Malawi accepted the Government's certification that this had been done only to determine four months later, while monitoring the account, that it did not earn interest. USAID/Malawi subsequently deleted this requirement in an amendment to the grant agreement. In answering this audit objective concerning obligating and disbursing funds for program cash transfers, we considered it reasonable for USAID/Malawi to have accepted the Government's certification that the condition had been met and since the grant agreement was amended we did not consider the situation to constitute non-adherence with applicable grant provisions and agency policies. However, we believe the issue of interest-bearing local currency accounts should be re-evaluated as discussed under the next audit objective (see page 8).

Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in monitoring the generation, deposit and use of program local currencies?

In our opinion, USAID/Malawi has followed applicable grant provisions and agency policies and procedures in monitoring the generation and use of program local currencies. However, USAID/Malawi has not followed applicable agency policies and procedures in monitoring the depositing of program local currencies. We believe USAID/Malawi's waiver of the A.I.D. policy preference for depositing program-generated local currency funds in an interest-bearing account was not supported by the information provided by the Government.

USAID/Malawi has ensured that local currency was generated by the Government to match the amount of program cash transfers as required by the program grant agreement. Documentation in USAID/Malawi's program files showed that the Government deposited the local currency equivalent of $20 million to an account in the Reserve Bank of Malawi within 30 days of the MED cash transfers and at the rate of exchange in effect at that time.

In addition, the use of these local currency funds was closely monitored by USAID/Malawi as required by A.I.D. policy and the grant agreement. USAID/Malawi and the Government have established procedures for the use and accounting of local currency accounts and we found that these procedures have been followed although the Government has been slow in submitting documents to USAID/Malawi. As of April 30, 1991, Malawi kwacha (MK) 32.3 million (approximately $11.96 million) had been withdrawn from the special account including the transfer of MK5.4 million (approximately $2 million) to the USAID/Malawi Trust Fund as required in the grant agreement. Each of the 13 withdrawals from the account had been previously approved by USAID/Malawi, documentation was on file at USAID/Malawi to support the expenditures, and the uses of the funds fell within the broad development parameters specified in the grant agreement.

However, as discussed below, USAID/Malawi's waiver of the A.I.D. policy preference for depositing local currency generations in an interest-bearing account was not supported by information presented by the Government and the issue should be renegotiated with the Government.

Local Currency Funds Should Be Placed In An Interest-Bearing Account

Local currency generated under the MED Program has not been placed in an interest-bearing account contrary to an A.I.D. policy preference and the original program grant agreement.

This occurred because USAID/Malawi waived the requirement as provided for in the A.I.D. policy. However, we believe the waiver and deletion of the interest-bearing account requirement from the grant agreement was not supported by the information presented by the Government in its request for relief from this requirement and that the issue should be renegotiated with the Government. Although the Government claimed that establishment of an interest-bearing account would undermine World Bank and IMF stabilization agreements, the evidence presented did not support this claim. The MED local currency special account could have earned the equivalent of approximately $1 million in interest between October 1988 and April 1991 if placed in an interest-bearing account. Interest earnings during the last three years of the program could total an estimated MK1.99 million ($635,648) to be used to further the objectives of the program.

Recommendation No. 1: We recommend that the Director, USAID/Malawi:

1.1 negotiate with the Government the requirement to place MED Program local currency generations in an interest-bearing account, and

1.2 negotiate with the Government a requirement to deposit all local currency generations under any other ongoing USAID/Malawi program to an interest-bearing account.

A.I.D. Supplemental Guidance to Policy Determination Paper No. 5, dated October 21, 1987, recommended that local currency be placed in interest-bearing accounts. This policy was recently reiterated in A.I.D. Policy Determination Paper No. 18, dated July 30, 1991. In accordance with this policy, the MED grant agreement, dated August 29, 1988, required that local currency generated from this program be placed in an interest-bearing account as one of the conditions precedent for the first tranche of program cash transfers. A.I.D. policy allows the requirement for interest-bearing accounts to be waived when such accounts (1) are not permitted under host country law, or (2) would undermine internationally-supported stabilization agreements and sound monetary policy.

As of April 30, 1991, MED local currency totalling approximately MK 21.67 million ($7.8 million) was held in a non-interest bearing account at the Reserve Bank of Malawi. These funds remain from the MK54 million ($20 million) the Government was required to deposit after receiving cash transfers of $15 million on September 29, 1988, and $5 million on December 29, 1989. In January 1989, four months after the first cash transfer was made, USAID/Malawi officials reviewed the bank statement for the special account and found that it was not in an interest-bearing account. Government officials had erroneously certified that the account was interest-bearing but explained that they had determined the creation of an interest-bearing account would require a significant budgetary outlay and would violate its agreement with the IMF and World Bank that severely limited Government expenditures. Accordingly, USAID/Malawi accepted the Government's explanation and on June 15, 1989, granted a waiver of this requirement as allowed by A.I.D. policy. Also, Amendment No. 4 to the grant agreement, dated July 17, 1989, deleted the requirement for an interest-bearing account as a condition precedent for the cash transfer that had already been made.

However, a close analysis of the information provided by the Government and our discussion with a Ministry of Finance (MOF) official disclosed discrepancies in the Government's statement seeking a waiver of the interest-bearing account requirement. It is unclear why the establishment of an interest-bearing account in a commercial bank would require a budget outlay and no evidence was provided by the Government to show that the requirement would actually be in violation of agreements with the IMF or World Bank. The Under Secretary for Revenue and Budget for the MOF told us that creating such an account did not require any budget modification or constitute an expenditure of funds. He explained that special accounts established pursuant to grant agreements with donors are all subaccounts of the Government of Malawi's "Consolidated Fund" and it makes no difference if they are in the Reserve Bank or a commercial bank. He also explained that although the Government's policy is to maintain its accounts in the Reserve Bank of Malawi, it is not prohibited by law from depositing any of its accounts in commercial banks.

The possibility of depositing the local currency equivalent of as much as $22.8 million in local currency equivalent ($7.8 million in existing deposits and $15 million to be generated by the remaining cash transfer) in a commercial bank was also discussed with a manager of the Commercial Bank of Malawi who stated that the bank could find borrowers for these funds and pay at least three percent interest on the account. The MOF official's comments and the Government's earlier statement on the subject were discussed with USAID/Malawi officials who explained that the Government had earlier voiced a strong preference for keeping these funds in the Reserve Bank and that the Mission believed the information provided by the Government, although not explained in great detail, was adequate for granting the waiver.

The MED local currency special account could have earned approximately $1 million in interest (in local currency equivalent) between October 1988 and April 1991 if these funds had been placed in an interest-bearing account earning only three percent. If the remaining MED local currency deposits and the local currency generated by the final $15 million tranche in MED cash transfers were placed in an interest-bearing account, earnings on these funds during the last three years of the program could total an estimated MK1.99 million

($635,648).[2] The grant agreement for another program signed on September 30, 1991 -- the Agricultural Sector Assistance Program -- includes local currency generations of $20 million that should also be placed in an interest-bearing account. The local currency generated by this program could earn an estimated $456,165 in interest over the three-year life of the program.[3]

Based on the above, we concluded that USAID/Malawi needs to renegotiate with the Government to transfer the remaining and future local currency associated with the MED special account to an interest-bearing account. In addition, USAID/Malawi should require local currency generations for all other USAID/Malawi programs to be placed in interest-bearing accounts. Mission officials agreed the issue of interest-bearing special accounts could be reopened in their negotiations with the Government but stated it would be difficult to obtain agreement to move the existing local currency to an interest-bearing account.

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[2] Calculated using a three percent interest rate with disbursements made at an even rate over the remaining three years of the program. An exchange rate of MK2.7 = $1 was used for the months through March 1992 and MK3.22 = $1 for subsequent months. The existing local currency would generate an estimated MK.34 million ($124,392) and future local currency deposits, excluding trust fund contributions, would generate the remaining MK1.65 million ($511,256) if deposited at the beginning of the third quarter of fiscal year 1992.

[3] Calculated using a three percent interest rate and an exchange rate of MK3.22 = $1 with disbursement made at an even rate over the three year life of the program. Local currency would be generated at time intervals as suggested by the program assistance approval document.

Did USAID/Malawi follow applicable grant provisions and agency policies and procedures in monitoring the performance of the program's technical assistance grantee and in obligating and spending funds for these activities?

In our opinion, USAID/Malawi followed applicable grant provisions and agency policies and procedures in obligating funds for the MED Program's technical assistance contractor. However, USAID/Malawi did not follow agency policies and procedures in monitoring the performance of the technical assistance grantee and in the spending of funds for these activities.

As of September 17,1991, all of the $1.6 million in project assistance for the MED Program had been obligated. USAID/Malawi's grant agreement and subsequent amendments with the Government of Malawi are the obligating documents for these funds that are to be used for technical assistance as well as for studies and training and were prepared in accordance with agency policies and procedures. Approximately $1.1 million of these funds are earmarked for technical assistance provided by the International Executive Service Corps (IESC).

Regarding monitoring of IESC's performance, USAID/Malawi did not have adequate information concerning the technical assistance grantee's activities to effectively monitor its success in implementing the program's objectives and complying with the terms of the grant. Monitoring reports required in the grant agreement were not submitted by the contractor and USAID/Malawi did not use procedures detailed in A.I.D. Handbook 3 to monitor the grantee's performance. Regarding the spending of these funds, USAID/Malawi authorized a drawdown on IESC's letter of credit with USAID although IESC's invoice did not contain enough information to determine if $46,700 in services billed for had been provided. Both of these problem areas are fully described below.

Improvements Needed In
Monitoring Grantee Performance

USAID/Malawi did not enforce applicable grant provisions and did not follow agency policies and procedures in monitoring the performance of IESC -- the MED Program's technical assistance grantee. Most of the reports required by the IESC grant agreement were not submitted by IESC and the program officer did not have an effective system of monitoring grantee performance. This breakdown in the monitoring process occurred because the program officer had responsibility for several projects and did not give monitoring of this particular grant high priority. Also, USAID/Malawi was relying on an upcoming mid-term evaluation of the grant to identify any problems and weaknesses in its implementation. As a result, USAID/Malawi has insufficient information to determine whether IESC is operating effectively. Consequently, approximately $86,000 or 41 percent of the estimated $210,000 in services provided under the IESC grant have been provided to parastatals and large firms and billed to A.I.D. contrary to IESC's grant agreement and the stated objectives of the MED Program.

> **Recommendation No. 2: We recommend that the Director, USAID/Malawi:**
>
> **2.1 establish a system of monitoring and controlling the activities and performance of the International Executive Service Corps (IESC) under its grant agreement with USAID/Malawi -- including tracking the submission of the various planning, progress and evaluation reports identified in the grant agreement and reviewing these reports to determine whether the grantee's activities conform with the grant agreement, and**
>
> **2.2 report to the Assistant Administrator the problem of monitoring technical assistance contractors and grantees as a material weakness in the next Federal Managers' Financial Integrity Act reporting cycle if this weakness is not corrected.**

A.I.D. Handbook 3, Chapter 11 states that the program officer has primary responsibility for monitoring a program to ensure technical services financed with USAID funds are being utilized effectively to produce the intended benefits. The program officer should generally follow all aspects of program implementation and keep current information on the progress of the program. The program officer is also responsible for establishing a suitable program monitoring system and ensuring that it operates effectively. Monitoring can be accomplished in several ways including the use of site visits, periodic contractor reports, financial or cost reports and consultations with the contractor/grantee and program participants.

The grant agreement with IESC requires the grantee to submit several different reports that would enable the program officer to monitor all phases of IESC's activities from the planning of client business consultancies to reviewing the performance of the consultancy. These reports include: (a) a quarterly report describing activities and projects performed and the results of the country director's attempts to place additional VEs, (b) project evaluation reports, (c) detailed proposals for anticipated consultancies to be performed, (d) client businesses' agreements with IESC, and (e) VEs' final reports to client businesses.

A review of USAID/Malawi program files and discussions with USAID/Malawi officials, the IESC country director and officials of four of the ten client businesses already assisted showed that USAID/Malawi exercised little control and oversight over the activities of IESC and the direction it was taking in providing technical support to businesses in Malawi. Through discussion with the IESC-Malawi country director and a review of the IESC consultancies already completed it was determined that IESC-Malawi was using program resources to provide its services to virtually any interested business entity in Malawi. The IESC-Malawi country director had extended his promotional efforts to include large parastatals such as Air Malawi and stated he was unaware of grant restrictions on assisting parastatals and USAID/Malawi had not instructed IESC to discontinue this assistance. As described below, weaknesses in monitoring grantee performance included monitoring reports required by the IESC grant agreement not being submitted by the grantee and site visits not being made to client businesses by USAID/Malawi officials.

Missing Monitoring Reports - Most of the monitoring reports required in the IESC grant agreement had not been submitted by the grantee and USAID/Malawi did not have alternate sources of information concerning IESC activities to properly monitor IESC's activities and performance. The project officer had either never asked for or had no success in obtaining from IESC the following reports required in the grant agreement:

- IESC-Malawi was to submit a quarterly report describing the progress of its consultancies and its activities to find additional Malawi businesses interested in receiving IESC assistance. These quarterly reports had never been prepared.

- The grant agreement calls for IESC-Malawi to submit a detailed proposal for each consultancy it plans to perform to give USAID/Malawi the opportunity to identify those that are unacceptable for funding under the grant. USAID/Malawi had never received these proposals.

- IESC-Malawi was to submit a copy of each of its agreements with client businesses. These agreements had never been submitted to USAID/Malawi.

- The grant agreement calls for IESC-Malawi to submit a final report for each consultancy to include a comprehensive review and discussion of its activities and accomplishments. USAID/Malawi had received only one of the ten final reports prepared by VEs that summarize the work performed at client businesses.

Site Visits Not Made - Although site visits are a common tool for monitoring grantee performance, none of the ten client businesses receiving assistance under the MED Program had been visited by USAID/Malawi officials. USAID/Malawi officials had met with the volunteer executives either individually or as a group during their consultancies in Malawi but none of the businesses had ever been visited by the program officer and none of the management officials of these businesses had been contacted regarding their views of the success or failure of the IESC consultancy or whether adjustments in IESC operations are needed.

In addition, the foregoing problems with program monitoring were not reported as material weaknesses by USAID/Malawi in the last Federal Managers' Financial Integrity Act reporting cycle.

In our discussions with the program officer it was pointed out that these monitoring problems occurred because the grant was part of one of several projects the officer was managing. In addition, USAID/Malawi officials stated that they were relying on a mid-term evaluation of the program, scheduled for the fall of 1992, to identify any weaknesses or necessary changes in program implementation. Further, the contractor's and client businesses' location in Blantyre was cited as making it difficult to perform any site visits as well as hampering effective communications with the grantee concerning the grant.

As a result of the lack of program monitoring, USAID/Malawi had not obtained sufficient information to determine whether IESC was utilizing program resources effectively, delivering its services as called for in the grant agreement or producing the intended benefits to Malawi businesses. Without monitoring or oversight of its activities by USAID/Malawi, IESC has used a significant portion of grant resources to benefit parastatals and other businesses that the program is not designed or intended to assist.

For example, four of the ten consultancies already completed by IESC had been for parastatals or entities wholly or partially owned by parastatals. These consultancies represent approximately $86,000 or 41 percent of the estimated $210,000 in costs already incurred under the grant. IESC was also planning two additional parastatal consultancies in the near future and another consultancy was planned with a firm that may be partially owned or controlled by a large multinational corporation although the project's intended beneficiaries -- according to the grant agreement with IESC -- are "small and medium-sized" businesses.

Based on the foregoing we concluded that USAID/Malawi needed to establish a system to monitor implementation of the MED Program in accordance with the grant agreement. An evaluation can not serve as a substitute for program monitoring and a lack of monitoring now will only increase the possibility of a negative assessment in a future program evaluation. Further, we believe that the weakness in program monitoring is a material weakness and should be reported under the Federal Managers' Financial Integrity Act in the next reporting cycle if the weakness is not corrected.

Payments To Contractor Should Be Supported By Complete Cost Information

USAID/Malawi has not complied with A.I.D. Handbook 19, Chapter 3 in authorizing payment to IESC. Although the voucher submitted by IESC did not contain the necessary details to help determine specifically what USAID/Malawi was paying for, the program officer expedited the contractor's payment by administratively approving the voucher on the basis that the contractor had provided services and was owed something. However, without adequate details of the costs included on the IESC voucher, USAID/Malawi could not determine the allowability of $46,700 that was claimed and paid.

Recommendation No. 3: We recommend that the Director, USAID/Malawi:

3.1 determine the allowability and collect, as appropriate, $46,700 in unsupported costs, and

3.2 establish procedures to ensure detailed financial and cost information is obtained from the International Executive Services Corps before authorizing any further payments of grant funds.

A.I.D. Handbook 19, Chapter 3 places monitoring responsibility on the program officer to represent A.I.D.'s interests during all phases of program operations and ensure the prudent and effective use of USAID resources. A.I.D. Handbook 19 states that program officers are to administratively approve all vouchers submitted for payment since the project officer is in a position to know or find out -- before payments are made -- if services have been performed pursuant to the contract or grant. The program officer's approval signifies that to the best of his/her knowledge, the voucher reflects costs incurred for the purposes of the agreement.

USAID/Malawi had inadequate information on IESC-Malawi costs to properly authorize payment to IESC headquarters in Stamford, Connecticut. All payments under this grant are made through the letter of credit (LOC) method of payment and the program officer is required to review and administratively approve any voucher submitted by the grantee for payment. Only one request for payment to IESC had been submitted, approved and paid as of September 30, 1991. These costs are unsupported as neither the IESC-Malawi country director nor USAID/Malawi officials could explain what specific IESC costs were included in IESC-Stamford's voucher or how the billed amount was computed.

The program officer explained that the voucher was authorized for payment because it was clear that IESC was owed something for the work performed. An annotation to this effect had been added to the bottom of the voucher before it was returned to AID/W for processing and it was expected that the problem would be resolved with IESC before the next voucher was submitted. However, there was no evidence of any communication between USAID/Malawi and IESC-Malawi or IESC-Stamford to attempt to remedy this problem. As a result, $46,700 was paid to the grantee without complete supporting documentation that the services paid for had in fact been provided.

Without an adequate review of IESC vouchers by the program officer, USAID/Malawi has no assurance that payments to IESC are for services already provided. USAID/Malawi should obtain detailed financial and cost information to determine the allowability of the unsupported costs of $46,700 already paid the contractor. In addition, USAID/Malawi needs to ensure that IESC officials provide detailed cost information to support its invoices before the Mission authorizes any additional payments.

REPORT ON INTERNAL CONTROLS

This section provides a summary of our assessment of internal controls for the audit objectives in our audit of the Malawi Enterprise Development Program (MED).

Scope of Our Internal Control Assessment

We conducted our audit in accordance with generally accepted government auditing standards, which require that we (1) assess the applicable internal controls when necessary to satisfy the audit objectives and (2) report on the controls assessed, the scope of our work and any significant weaknesses found during the audit.

We limited our assessment of internal controls to those controls applicable to the audit's objectives and not to provide assurance on the auditee's overall internal control structure. We have classified significant internal control policies and procedures applicable to the audit objectives by categories. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation -- and we assessed control risk. We have reported these categories as well as any significant weaknesses under the applicable section heading for each audit objective.

General Background on Internal Controls

Recognizing the need to re-emphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Managers' Financial Integrity Act (the Integrity Act) in September 1982. Under this Act and Office of Management and Budget implementing policies, the management of A.I.D., including USAID/Malawi, is responsible for establishing and maintaining adequate internal controls. Also, the U.S. General Accounting Office has issued Standards for Internal Controls in the Federal Government to be used by agencies in establishing and maintaining such controls.

The objectives of internal controls and procedures for Federal foreign assistance 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.

Conclusions for Audit Objective No. 1

This objective concerned USAID/Malawi's obligating and disbursing funds for cash transfers to the Government of Malawi. In planning and performing our audit of USAID/Malawi's cash transfer processes, we considered the applicable internal control policies and procedures cited in (1) A.I.D. Handbook 1, Part IV.1, (2) A.I.D. Handbook 3, (3) A.I.D. Handbook 4, Chapter 8, and (4) A.I.D. Handbook 19, Appendix 1A. For the purpose of this report, we have classified the relevant policies and procedures into the following categories: the cash transfer planning, agreement and accounting processes.

We reviewed USAID/Malawi's internal controls relating to these processes and our tests showed that the controls were logically designed and consistently applied. We reviewed all information and documentation received and prepared by USAID/Malawi before funds were released to the Government of Malawi.

Conclusions for Audit Objective No. 2

This objective concerned USAID/Malawi's monitoring of the generation, deposit and use of program local currencies generated by the MED Program. In planning and performing our audit of USAID/Malawi's local currency processes, we considered the applicable internal control policies and procedures cited in A.I.D. Handbook 1, A.I.D. Policy Determination Paper No. 5 and the Supplemental Guidance on Programming Local Currency dated October 1987. For the purpose of this report, we have classified the relevant policies and procedures into the following categories: the local currency deposit process and the joint programming and spending process.

We reviewed USAID/Malawi's internal controls relating to these processes and our tests showed that the controls were logically designed and consistently applied except the program's local currency generations had not been placed in an interest-bearing account. However, we performed additional tests to examine the reasons why this policy was waived and to determine whether USAID/Malawi had documentary evidence to support this decision.

Conclusions for Audit Objective No. 3

This objective concerned USAID/Malawi's monitoring of the performance of the program's technical assistance grantee and in obligating and spending funds for these activities. In planning and performing our audit of USAID/Malawi's contractor/grantee monitoring process, we considered the applicable internal control policies and procedures cited in A.I.D. Handbooks 3 and 19. For the purpose of this report, we have classified the relevant policies and procedures into one category: the program monitoring process.

We reviewed USAID/Malawi's internal controls relating to the program monitoring process. Our assessment showed that the controls were not properly designed and/or implemented, therefore they could not be relied on. The control weaknesses identified included:

- USAID/Malawi did not follow guidance in A.I.D. Handbook 3, Chapter 11 to actively monitor the performance of the MED Program's technical assistance grantee. The program monitoring system established in the grant with the International Executive Service Corps was not operating effectively with many of the required reports necessary to monitor the grantee's performance never being submitted to USAID/Malawi by the grantee.

- The program officer administratively approved payment of the grantee's billing without having adequate information to determine what services the billing covered. Procedures in A.I.D. Handbook 19, Chapter 3 place this responsibility on the program officer who is supposed to know if the services on the bill have been performed.

As a result of these internal control weaknesses, we expanded our tests to determine what effect, if any, these weaknesses had on the grantee's implementation of the grant agreement. These tests included a review of all monitoring reports on file at USAID/Malawi and site visits to four of the ten businesses that had received assistance from the grantee.

As part of our review of USAID/Malawi's internal controls, we also reviewed the Mission's Annual Internal Control Certification under the Federal Managers' Financial Integrity Act dated November 9, 1990, and the Mission's general assessment for 1990 dated March 28, 1991. The certification and the general assessment did not note the conditions discussed above. Therefore we have recommended that these weaknesses, if uncorrected, be reported during the next reporting cycle.

REPORT ON COMPLIANCE

This section provides a summary of our conclusions on USAID/Malawi's compliance with applicable laws and regulations.

Scope of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards, which require that we (1) 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 (2) 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.

We tested USAID/Malawi's compliance with the program grant agreement and the grant agreement with the International Executive Service Corps (IESC) as they relate to our audit objectives. However, our objective was not to provide an opinion on the Mission's overall compliance or enforcement of such provisions.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grants and binding policies and procedures governing an organization's conduct. Noncompliance constitutes an illegal act when there is a failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance and criminal acts. 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 distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the letter of the laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior. Compliance with the program grant agreement and the technical assistance grant agreement is the overall responsibility of USAID/Malawi's management.

Conclusions on Compliance

Our tests showed that USAID/Malawi complied with applicable sections of the program grant agreement and the technical assistance grant agreement with IESC.

MANAGEMENT COMMENTS AND OUR EVALUATION

USAID/Malawi comments on the audit findings and recommendations in the report are summarized below with our response.

Concerning Recommendations 1.1 and 1.2, USAID/Malawi stated that it continues to believe the information provided by the Government provided a sufficient basis for granting a waiver of the requirement for local currency funds to be maintained in an interest-bearing account. USAID/Malawi explained that the Government does not use commercial banks for any of its accounts except in rare instances and then only after the Minister of Finance verifies that sufficient funds are available in the Ministry's budgetary ceiling.

USAID/Malawi, however, reopened discussions with the Government on this point and obtained an agreement to open an interest-bearing account for the deposit of local currency under the Agricultural Sector Assistance Program (ASAP). Regarding local currency funds generated by the Malawi Enterprise Development Program (MED), USAID/Malawi expects the remaining funds to be utilized very quickly to cover costs associated with the drought relief effort. The remaining $15 million in MED cash transfers (and associated local currency generations) have been cancelled and there are no other ongoing generations of local currency. USAID/Malawi requested that these recommendations be resolved and closed.

We commend USAID/Malawi for its success in obtaining the Government's agreement to open its first interest-bearing account for the ASAP local currency funds. However, Recommendation 1.2 must remain unresolved until RIG/A/N obtains concurrence from USAID/Malawi on the specific dollar amount connected with this recommendation. This amount, $456,165, is our estimate of the interest that could be earned over the three-year life of the program. Recommendation 1.2 will be resolved and closed when RIG/A/N receives USAID/Malawi's agreement with this estimate. USAID/Malawi's explanation regarding the remaining MED local currency funds is considered acceptable for closing Recommendation 1.1.

Regarding Recommendations 2.1 and 2.2, USAID/Malawi reports that its management of the International Executive Services Corps (IESC) in Malawi has improved measurably over the last eight months and describes a monitoring system that includes submission of all required reports and detailed financial reports by IESC in addition to regular meetings with the IESC country director. As a result of these improvements, USAID/Malawi states that there is no longer a reportable weakness under the Federal Managers' Financial Integrity Act.

USAID/Malawi also offered several comments concerning information presented in the audit report on its monitoring of IESC activities. USAID/Malawi stated that five of the ten business firms assisted by IESC at the time of the audit had been visited by various mission officials either during or following the IESC consultancy. USAID/Malawi also stated that only two of the assisted firms were parastatals and that the program emphasis on small and medium scale firms related to the creation of new enterprises while IESC works principally with established firms. Finally, USAID/Malawi stated that it in the future it will formally address the question of whether it should waive the grant requirement that parastatals pay the full cost of an IESC consultancy when a parastatal lacks adequate financial resources to pay for the consultancy. USAID/Malawi requested that these recommendations be resolved and closed.

RIG/A/N applauds USAID/Malawi's efforts to improve its monitoring of the IESC-Malawi grant. The monitoring system described in the Mission's response should enable USAID/Malawi to determine whether the grantee is complying with the terms of the grant. Therefore, Recommendations 2.1 and 2.2 are resolved. They can be closed upon receipt of a sample of the following items received or produced by USAID/Malawi since December 1991: consultancy proposal, consultancy agreement, IESC quarterly report and a memorandum detailing one of USAID/Malawi's regular meetings with the IESC director.

We reviewed USAID/Malawi's other comments regarding the facts in the report related to these recommendations and made some wording changes, as appropriate. However, information we obtained during the audit does not support many of the points raised by USAID/Malawi. Our statement that IESC-assisted firms had not been visited by USAID/Malawi officials was based on (1) our discussions with the IESC country director and officials at four of the businesses, and (2) the lack of any site visit reports in the program files. This matter was also discussed during interim and exit discussions and was not disputed at those times. Our statement that four of the ten IESC-assisted firms were wholly or partially owned by parastatals was supported by discussions with officials of the firms and IESC records. In addition to the two firms cited by USAID/Malawi, we found that Portland Cement is wholly owned by a parastatal and Stagecoach is 49 percent owned by the Government. We questioned USAID/Malawi's willingness to pay for IESC assistance to parastatals because of restrictions in IESC's grant agreement with USAID/Malawi. Similarly, we questioned IESC assistance to large firms because the grant agreement specifically states its intended beneficiaries are "small and medium sized" firms. If USAID/Malawi believes these restrictions contradict the project design it should amend the grant accordingly.

Concerning Recommendations 3.1 and 3.2, USAID/Malawi reported that the USAID/Malawi country director has provided the Mission with a detailed breakdown of costs for its consultancies and has agreed to provide similar information for its operations in the future. The questioned IESC voucher of $46,700 was submitted against costs of $118,110 and the detail was considered sufficient by USAID/Malawi to determine the allowability of the payment. USAID/Malawi requested that these recommendations be resolved and closed.

We believe that USAID/Malawi's success in obtaining detailed financial information to support IESC claims for reimbursement directly addresses Recommendation 3.2 which is therefore resolved. It will be closed upon receipt by RIG/A/N of an example of the detailed financial reports submitted to USAID/Malawi since December 1991. However, this detailed cost information would not, by itself, be sufficient for USAID/Malawi to determine the allowability of the questioned costs of $46,700 in the voucher cited in Recommendation 3.1. This voucher covered the time period prior to March 1991 when the grant agreement with IESC only allowed a fixed payment per consultancy. Reimbursement for all consultancy costs did not become part of this grant until the second grant amendment in April 1991. A determination that these costs are allowable can only be made by IESC providing USAID/Malawi with a listing of the consultancies and fees making up the $46,700 voucher. Recommendation 3.1 is therefore unresolved. It can be resolved and closed when USAID/Malawi determines the allowability of the questioned costs of $46,700 by obtaining and reviewing an IESC listing as described above.

SCOPE AND METHODOLOGY

Scope

We audited the Malawi Enterprise Development Program in accordance with generally accepted government auditing standards. Our audit was conducted from September 16, 1991, through March 11, 1992, and covered all of the program's obligations and disbursements totaling $36.6 million and $20.09 million, respectively, as of September 17, 1991. Additional technical services totaling approximately $163,300 had also been provided by the International Executive Service Corps (IESC) but had not yet been paid for and these services were also included in our audit scope.

The audit did not include the operating costs of IESC in Malawi which will eventually be charged to the MED Program as this was outside our objectives and scope. Similarly, the audit did not include the expenditures of host country-owned local currencies generated by this program. However, the audit did include an analysis of USAID/Malawi's system for determining whether the correct amount of local currency funds was deposited in the special account and its system of monitoring how the Government of Malawi was using these funds.

Our audit was conducted in the offices of USAID/Malawi. We also held discussions with host country and local banking officials, the technical assistance grantee's local representative and various business clients provided technical assistance under the program. However, we did not audit any entity other than USAID/Malawi since this was outside our objectives and scope. The audit evidence gathered included oral explanations and documentary evidence provided by USAID/Malawi officials, host government and local banking officials, the technical assistance grantee and client businesses. We also performed analyses of the documentation provided by these entities. There were no prior audit findings to review because the Malawi Enterprise Development Program had not been previously audited.

As part of this audit we also examined USAID/Malawi's internal controls, related to the program, for (a) cash transfers, (b) monitoring the generation, deposit and use of local currencies, and (c) monitoring and payment of the technical assistance grantee.

Methodology

The methodology for each audit objective follows.

Audit Objective One

For the first audit objective, we tested $20 million -- 100 percent -- of the two cash transfers made as of September 17, 1991, to verify that the conditions precedent in the program grant agreement had been met before the cash transfers were made. We determined if MED cash transfers were made in accordance with A.I.D. procedures by examining the evidence and documentation gathered and prepared by USAID/Malawi to show that conditions precedent were met. This evidence consisted of Government laws and decrees, budgetary statistics, Reserve Bank of Malawi statistical summaries and listings of materials and spare parts removed from exchange control procedures.

Audit Objective Two

In answering the second audit objective, we determined whether USAID/Malawi followed A.I.D. policies and procedures to ensure the correct amount of local currency was deposited and that local currency was spent as jointly programmed by USAID/Malawi and the Government of Malawi. To accomplish this we reviewed USAID/Malawi's system of monitoring these funds including an analysis of the procedures established by USAID/Malawi and the Government of Malawi for the allocation, use and accounting of local currencies generated under USAID-financed assistance programs.

We reviewed the bank statements for the MED local currency special account and determined whether the correct amount of local currency was deposited. USAID/Malawi's waiver of USAID policy that these funds be placed in an interest-bearing account was also analyzed to determine whether the justification was valid. We also reviewed the adequacy of supporting documentation on file at USAID/Malawi for all account withdrawals -- Malawi kwacha 32.3 million ($11.96 million) -- and determined whether each had been given prior approval by USAID/Malawi management and whether the use of the funds was in accordance with the grant agreement.

Audit Objective Three

To answer the third audit objective, we determined whether USAID/Malawi followed applicable grant provisions and agency policies and procedures in monitoring the performance of the program's technical assistance grantee and in obligating and spending funds for these activities.

To accomplish the above, we reviewed the technical assistance grant agreement and USAID/Malawi's project files to determine whether IESC was providing USAID/Malawi the various progress and performance reports called for in the grant agreement. We interviewed the program officer to determine how USAID/Malawi monitors the activities and performance of the grantee and how it determines the validity of the grantee's invoices. We examined the technical assistance project review reports for each of the 10 business consultancies completed by the grantee as of September 30, 1991, and discussed with the program officer the results of these consultancies and whether they met the criteria established in the grant agreement. We similarly reviewed the grantee's list of ongoing and planned consultancy projects to determine whether these businesses were among the program's intended beneficiaries.

We also interviewed the IESC Country Director and management officials of four of the ten businesses that had received technical assistance to obtain additional information for determining whether services were being provided in accordance with the grant agreement. The four business managers that were interviewed were randomly selected from those individuals that were available for site visits during audit fieldwork. These businesses were considered to be a representative sample of IESC-assisted businesses and included parastatals and non-parastatals as well as both large and small commercial operations.

The audit also included a review of unliquidated obligations of program funds to determine whether USAID/Malawi had adequate documentation to support the obligations.

memorandum

DATE: 29 July 1992

REPLY TO ATTN OF: Carol A. Peasley, Mission Director

Carol Peasley

SUBJECT: Draft Audit of the Malawi Enterprise Development Program (612-0233)

TO: John Burns, RIG/A/Nairobi

The purpose of the Malawi Enterprise Development (MED) Program audit was to determine whether USAID/Malawi followed (1) applicable grant provisions and agency policies and procedures for obligating and disbursing funds for cash transfers under the Malawi Enterprise Development Program, (2) applicable grant provisions and agency policies and procedures in monitoring the generation, deposit and use of program local currencies, and (3) applicable grant provisions and agency policies and procedures in monitoring the performance of the program's technical assistance contractor and in obligating and spending funds for these activities.

The audit found that applicable grant provisions and agency policies and guidance were followed in obligating and disbursing funds for cash transfers to the Government of Malawi (GOM). In addition, the audit found that USAID/Malawi followed agency policies and procedures in monitoring the generation and use of local currencies.

However, there is a difference of opinion between the Mission and the audit finding that agency policies regarding the monitoring of the deposit of local currencies. Moreover, the audit found that USAID/Malawi did not follow applicable grant provisions and agency policies and procedures in monitoring the performance of the program's 'technical assistance contractor.' The three draft audit recommendations pertain to these findings, and are the subject of this memo.

Draft Recommendation No. 1:

> negotiate with Government the requirement to place MED Program local currency generations in an interest-bearing account, and
>
> negotiate with Government a requirement to deposit all local currency generations under any other ongoing USAID/Malawi program to an interest-bearing account.

The discussion under this recommendation states that the waiver and deletion of the interest-bearing account requirement from the MED grant agreement was not supported by information provided by the Government in its request for relief from the requirement. The discussion goes on to report that, in conversation with an Under Secretary for Revenue and Budget in 1991, the Ministry of Finance stated that the Government is not prohibited by law from depositing its accounts in commercial banks.

As I stated in my memo, dated 22 October 1991, following the Record of Audit Results, the Government does not maintain wholly-owned accounts in commercial banks as a matter of policy. Exceptions to this rule are rare: for wholly-owned accounts in commercial banks, the Minister of Finance must give his specific, personal approval, including verification that sufficient funds are available in the Ministry's budgetary ceiling. According to our discussions with Government officials, only one or two such accounts have been maintained in commercial banks (we believe one account at each of the two commercial banks are maintained). Senior officials in the Reserve Bank have verified that the current value of the accounts is MK 709,000, and that the accounts are used as a facility into which tax arrears payments are made by individuals to the GOM. Immediately following deposit into the commercial bank accounts, the resources are transferred into Government accounts in the Reserve Bank. The accounts, therefore, are maintained for a narrowly defined, specific purpose.

Thus, we continue to believe that the Mission was correct in its analysis and its decision to waive the requirement for local currency funds to be maintained in an interest-bearing account, and that the information provided to us at the time by Government provided a sufficient basis for that determination. Proper Agency procedures were followed in the preparation and approval of the waiver.

Nonetheless, on the basis of the draft record of audit results provided to the Mission in October, 1991, discussion on this point was re-opened with Government officials. As a result of those negotiations, Government agreed to open an interest-bearing account in a commercial bank for the deposit of local currencies under the Agricultural Sector Assistance Program (ASAP). This is Government's <u>only</u> permanently-held, interest-bearing account in a commercial bank. While operation of the account has run smoothly (e.g., timely deposit of local currencies into the account), management of the account is cumbersome. Instructions must come from Government to the Reserve Bank and on to the commercial bank with each transaction. It stretches already scarce management resources.

With respect to outstanding MED local currency deposits which could conceivably be transferred to interest-bearing accounts, please be advised that recent actions have resulted in remaining deposits being allocated to cover costs associated with the drought relief effort. We expect these funds to be utilized in an extremely expeditious manner, given the pressures that the drought is imposing on Malawi's economy and specifically on Government's budget.

Moreover, given the recent decisions at the Consultative Group meeting on Malawi held in Paris in May, A.I.D. has decided to cut back on assistance levels to Malawi. One of the first cutbacks announced was termination of the remainder of the balance of payments component of the MED Program. As a result, we are currently in the process of deobligating the remaining $15 million under the MED Program. Thus, there will be no future generations of local currency under MED. To summarize, therefore, existing local currencies under MED have been fully allocated, and no further generations can be expected.

For the Mission's only on-going activity that generates local currency deposits, ASAP, an interest-bearing local currency account has been negotiated with Government and is functioning well.

There are no other on-going project or non-project activities which generate local currency. Local currencies generated under completed activities are already, or are in the final stages of being, fully allocated.

The Mission believes, therefore, that it has complied with the intent of this draft recommendation, and that it should be closed.

Draft Recommendation No. 2:

> establish a system of monitoring and controlling the activities and performance of the International Executive Service Corps (IESC) under its grant agreement with USAID/Malawi -- including tracking the submission of the various planning, progress, and evaluation reports identified in the grant agreement and reviewing these reports to determine whether the contractor's activities conform with the grant agreement, and
>
> report to the Assistant Administrator the problem of monitoring technical assistance contractors as a material weakness in the Federal Managers' Financial Integrity Act reporting cycle if this weakness is not corrected.

As I reported to you in my memo of October 22, 1991, the Mission concurred with the tentative audit findings and agreed to take steps necessary to correct the situation. Since that time, the Mission has developed a system to monitor and control performance of activities under the IESC grant. The system includes submission to USAID/Malawi by IESC/Malawi of all required reports (detailed consultancy proposals, consultancy agreements, final consultancy reports, and quarterly reports). We have been receiving these reports regularly. In addition, we have asked that we be provided with detailed financial reports which allow detailed verification of expenditure claims. The project manager met regularly with the past IESC/Malawi country representative, and has already met several times with the new IESC country representative. A regular schedule of meeting and consulting between IESC and Mission staff, both in Blantyre and in Lilongwe, has, therefore, been instituted. IESC/Malawi has been responsive to our requests for regular consultations (as witnessed by the more than monthly meetings which have taken place since last December) as well as to our requests for regular submission of reports. Thus, the Mission feels that management of this activity has improved measurably over the last eight months, and no longer poses a weakness to the Federal Manager's Financial Integrity Act.

I would like to take this opportunity, however, to correct some factual errors in the draft report. First, on page 2 of the executive summary, the entire $1.6 million project component of MED is identified as our grant to IESC. As is later correctly stated, the actual amount of the IESC grant is $1.1 million, with the balance allocated to other project activities.

Second, on pages 25 and 26, the authors state that Mission personnel had on a few occasions met with one or more Volunteer Executives (VEs), but noted that none of the businesses had ever been visited by the project officer or Mission staff. In fact, each of the VEs had been visited by the project manager, and many by other Mission personnel as well. In addition, of the ten firms assisted by the time of the audit (Portland Cement; Candlex; Classic Designs; Malawi Railways; Trust Industries; Farming and Engineering; Fargo Ltd; Montfort Press; Stagecoach; and MACOHA) at least three firms were visited during the time of VE assistance by various Mission personnel, and a further two following the consultancies. Nonetheless, our performance in this regard also has improved since last September.

Third, draft Recommendation No. 2 incorrectly states that IESC is a technical assistance contractor; it is a grantee to which funds are made available through the Letter of Credit mechanism.

Comments on the parastatal status of several of the consultancies deserve separate mention. The goal and purpose of the MED program are focussed on enhancing private sector growth:

goal -- to increase incomes and the availability of employment in the private sector by stimulating growth of industry and commerce; and,

purpose -- to revitalize existing businesses and create new enterprises, particularly small and medium scale enterprises, by supporting policies aimed at reducing economic, institutional, and fiscal distortions which inhibit the development of a more open, competitive, and dynamic public sector.

The emphasis on small and medium scale firms specifically relates to the creation of new enterprises. IESC, by requiring significant client contributions, works principally with the revitalization of established firms. This was the intent of the original design.

Assistance to parastatal firms at less than full cost contribution by a firm was in violation to IESC's own procedures for assisting parastatals. A misunderstanding within the Mission on the required source of funding for the assistance to Malawi Railways resulted in partial payment for the consultancy under the IESC Grant rather than through the Mission's bilateral grant to Malawi Railways. This situation has been rectified, and will not recur. For MACOHA, the Mission should have formally waived the required full cost contribution by the Malawi Committee for the Handicapped (MACOHA) since the Mission recognized that MACOHA had no financial resources to pay for the consultancy. We do not expect to see such a situation again in the future; however, if we decide to support another such activity, we will formally address the question of contribution. Finally, of the ten firms assisted at the time of the audit, and listed above, only two were (are) parastatals -- Malawi Railways and MACOHA.

Thus, on the basis of the actions taken to resolve the implementation problems, as discussed above, the Mission requests that this recommendation be closed.

Draft Recommendation No. 3:

determine the allowability and collect, as appropriate, $46,700 in unsupported costs, and

establish procedures to ensure detailed financial and cost information is obtained from the International Executive Service Corps before authorizing any future payments of grant funds.

The Mission has written to IESC/Malawi to apprise them of the

Mission's need to have more detailed financial information before payments can be authorized. In response, the IESC/Malawi country director has provided the Mission with a breakdown of costs (by actual air fares, en route expenses, per diem, miscellaneous charges, recruiting costs, country director expenses, and field support costs) for each of the completed projects. For the period covered by the voucher, IESC verified that total costs of $118,110 had been incurred. The $46,700 voucher was submitted against these newly detailed actual costs, and the detail provided was sufficient to determine allowability.

IESC/Malawi understands our need for further financial detail to document the allowability of specific claims against the Letter of Credit. The country representative has been responsive to our request, and has assured us that similar financial detail will be provided in the future.

Therefore, on the basis of the above discussion and actions, the Mission requests that the above draft recommendation be closed.

draft: PAE:RMahoney
clear: FMO:RBAmin
PID:DEMcCloud

APPENDIX III

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