



CHEMONICS INTERNATIONAL INC.

FINAL DRAFT

THE CAISSE D'EPARGNE DE MADAGASCAR

PROGRESS REPORT

Contract no. PC-I-00-99-00007-00

Prepared for:

United States Agency for International Development
Antananarivo, Madagascar

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1. BACKGROUND

¹Although most external support for microfinance development in Madagascar currently targets networks of "*Mutuelles d'Epargne et Credit*" (MECs) and related associations, there are non-mutual organizations active in specialized micro-credit operations and savings mobilization. The CEM is a non-mutual savings institution that was originally established as the national postal savings bank, and continues to be the foremost provider of savings services to the poor in Madagascar. Although it continues to offer services through about 150 Post Office (PTT) windows throughout the country, it has evolved into an organization that operates independently from the PTT through a network of 8 independent agencies located in 7 cities throughout the country. The independent agencies account for approximately 80% of the total savings deposits managed by the CEM.

Under the Financial Market Development Project (FMD), initiated in 1993, USAID/Madagascar has developed a successful partner relationship with the CEM in expanding access to savings services for households, the informal business sector and the poor. Currently the CEM provides savings services to almost half a million clients representing over 6% of the adult population of Madagascar. Since the CEM represents such an important savings mechanism, its sustainability is essential.

Because of the great potential for the CEM to serve as an engine for expanding and deepening micro-finance services in Madagascar, USAID plans to continue working with the CEM as its primary partner in micro-finance development. However, the nature of continued support is uncertain because the CEM's legal status remains unacceptably ambiguous. The CEM was authorized in 1995 (through the promulgation of Law 95/019) to transform itself from an "*Etablissement Public a Caractere Industriel et Commercial*" (EPIC, or parastatal firm) to a "*Societe Anonym*" (S.A., or autonomous corporation), but has not yet completed the process.

In furtherance of the potential identified for the CEM, USAID issued an RFP in March 2000, whose primary objectives were stated as follows:

- To support the CEM in eliminating all ambiguities related to its legal status and in resolving all outstanding problems related to its legal transformation into an independent financial institution, which has corporate governance meeting best practices criteria;
- To lay the groundwork for enabling the CEM to become a clearly sustainable provider of an increased range of micro-finance services and products to an expanding clientele of poor households and micro-entrepreneurs.

In response to the RFP, the Chemonics team began work in April 2000 under its contract and fielded a team of three consultants in Madagascar in May and June, and three consultants in July,

¹ First 4 paragraphs of this section were adapted from the RFP issued by USAID for this project.

for tasks as approved under a Work Plan that was proposed to USAID and accepted in May. Additional work was performed offshore in the United States and United Kingdom during this period. In general, the team considers that the progress to date under the terms of this contract has been better than was anticipated when the work began for the following reasons: 1) The political climate for change was found to be favorable with respect to the clarification of CEM's legal status; 2) the CEM's internal situation and critical issues from this standpoint have been defined with corrective actions taken and implemented in many instances; 3) the team has been able to proceed to guide the CEM strategically toward a first step in the privatization process; and 4) cooperation with our counterparts at the CEM and the Government of Madagascar is as good or better than could have been expected.

This Progress Report, as required under the terms of the RFP, sets forth the following:

1. The status of work and activities implemented as of July, 2000 in relation to the Work Plan;
2. Services provided to Malagasy counterparts in the course of the work;
3. Results obtained;
4. Critical success factors for the CEM to be considered by USAID;
5. Next steps in the flow of work under the contract.

The Progress Report will also include attachments with drafts of a new law, decree, and by-laws for the CEM, an extensive report about the internal financial status of the CEM with a list of items of concern and corrective actions taken, a white paper about recommended profitability / sustainability measurements for the CEM with a diskette of this for use by USAID, a memo with preliminary comments about the 1999 Chemonics assessment report, a list of counterpart contacts, and a summary training plan.

2. STATUS OF WORK IN RELATION TO THE PLAN AND ACTIVITIES IMPLEMENTED

In May and June 2000 work was begun under an approved work plan, which may be considered to consist of 4 phases. Two out of four phases of the work have been completed and several recommendations and activities in the legal and financial management areas are in the process of being implemented.

Phase 1 of the work in May and June concentrated on: 1) clarification of the CEM's legal status; and 2) an assessment of the CEM's institutional soundness and corrective measures taken, and to be taken, in this area. In the course of this work, undertaken by Frederick Dulles, Legal Expert, Khai Nguyen, Financial Management Expert, and Warren Chase, Chief Technical Adviser, with qualified local support in Madagascar, new legal documents were drawn and discussed at length with the CEM and senior government officials at the Ministry of Finance for submission to Parliament. Moreover, a detailed assessment report based upon the Delta (Deloitte & Touche) audit and the team's own experience and observations, was completed, and assistance provided with internal corrective measures, several of which have been implemented and are being implemented.

In July for Phase 2 of the work, the team's attention was focused on continuing clarification of CEM's legal status and refinement of drafts of a new law and decree, and on beginning work on micro-finance strategy and share valuation and structuring, as this will become critical to CEM's business plan as part of its application for a banking license, and also relevant to a prospectus, or information memorandum, for the issuance of shares to private investors. A training plan was devised in accordance with the work plan, to be implemented in October, and a white paper was submitted to USAID with new concepts for measurement of profitability / sustainability for the CEM. Participants in the July work included Osman Shahenshah, Asset Restructuring / Privatization Expert, Frederick Dulles, Legal Expert, Judith Beckwith, Micro-finance Expert, and Warren Chase, Chief Technical Adviser (Ms. Beckwith provided advice and service offshore in June and July and will travel to Madagascar in October).

Phases 3 and 4 of the work under the Plan will occur in September / October and later (see Section 6 below "Next Steps" for a description of this).

Following is the table of tasks approved as part the Work Plan with the status of work and activities implemented in relation to each task:

STATUS OF TASKS AND ACTIVITIES
Madagascar CEM Project

TASK	PLANNED DURATION	IMPLEMENTATION AS OF JULY 28
<i>WORK ON CLARIFICATION OF LEGAL AND REGULATORY ISSUES TO REMOVE AMBIGUITIES</i>	May 15 – Mar 15, 2001	<i>Substantial progress --- new law and decree drafted by the team and due to be submitted to Parliament for approval in September or October. Consensus achieved.</i>
Identify issues re. implementation of 95/019 <ul style="list-style-type: none"> • Specific legal issues • Regulatory issues 	May 15 – July 28	<i>All legal and regulatory issues have been identified and corrective and implementing measures have been recommended.</i>
Prepare assessment report re. legal status	July 28	<i>Assessment report submitted.</i>
Checklist / action items for law as part of interim progress report	June 9-Jul 28	<i>Checklist submitted and attached hereto as Attachment 1.</i>
Draft legal documents or provide comment, to assist the CEM in eliminating ambiguities relating to its legal status, e.g., amendment to 95/019, possible decree attendant to 95/019, by-laws, contrat – programme between CEM and the	May 15 – Nov 30	<i>Draft new law and decree completed and attached hereto in Attachment 2. Final of by-laws will be done in September – October. Status of contrat programme will depend upon deliberations of Parliament and discussions with</i>

state.		<i>Malagasy counterparts. It is likely that the concept will be eliminated in the new law.</i>
Advise and assist with agreement in principle between CEM and Post Office, provide draft protocol d'accord for use by parties.	July 15 – Nov 30	<i>Difficult relations with the Post Office, involving fees charged to CEM depositors by the Poste, and the intent of CEM and the Post to pursue separate ways (the Poste perhaps to set up its own thrift institution), made this task difficult to implement. However, continuing effort will be made. The outlook for a new protocol d'accord is uncertain though desirable.</i>
Provide ongoing advice and knowledge as appropriate to the RFP and work plan with respect to CEM's possible application for a banking or operating license. Keep USAID updated on this process and its course.	May 15 – Mar 15, 2001	<i>Close contact and discussion with the CEM in this area has begun. In addition, visits have been made to the CSBF and knowledge gained about the licensing process. USAID will be updated continuously.</i>
INSTITUTIONAL DEVELOPMENT AND STRENGTHENING	May 15- Nov 30	<i>Substantial and concrete progress has been made in identifying several issues and in taking corrective actions. Collaboration with counterparts has been excellent and productive.</i>
Check for progress against Delta audit report and Chemonics Assessment Report for AID and assist CEM as appropriate in closing exceptions in the reports.	May 15– June 15	<i>Status in relation to the Delta audit has been checked (see Attachment 3), while a preliminary check against the Chemonics report was done (see Attachment 6). The reason for concentration on the Delta audit is that the team did not consider the Chemonics report as relevant as the Delta audit (Deloitte & Touche), with respect to technical concerns about operational soundness.</i> <i>Significant assistance has been provided to enable the closing of exceptions to the Delta report. Concerns in addition to those in the</i>

		<i>Delta and Chemonics reports were identified and corrective action taken (see Attachment 3). The most important recommendation in the Chemonics report about clarification of legal status has been addressed and progress made. More specific operational items in the Chemonics report will be addressed in October, as they may be applicable.</i>
<i>Review CEM performance yardsticks for change and develop one additional one for AID to track profitability / sustainability</i>	May 15 – July 28	<i>White paper submitted on schedule (see Attachment 5).</i>
ASSESS TAX LIABILITY AS EPIC AND AS SA AND ITS IMPACT ON SUSTAINABILITY / PROFITABILITY	May 15 – Jul 28	<i>Tax opinion has been requested from local counsel and a preliminary one has been prepared. Impact on sustainability / profitability not considered key to these measurements, as discussed in white paper on this subject (see Attachment 5 to this report). In fact the income tax rate for an EPIC is the same as that for the CEM. However, the report concludes that the CEM may be liable for 3 years' back income taxes as an EPIC, an issue that has been discussed with CEM management, which agrees that liability might well exist. It has addressed as part of the new draft law, as private investment will not happen in the absence of resolution. Its resolution is critical both to the timely submission of the law to Parliament as well as the ability of the CEM to obtain an unqualified audit opinion.</i>
<i>Assist the CEM in compliance with IASC / CSBF accounting standards and requirements and recommend steps as appropriate.</i>	May 15 – 28	<i>Assistance provided, especially in the areas of corrective measures to address exceptions in the Delta audit, accrual accounting practices, and the segregation of expense accounts (see Attachment</i>

		<i>3). An EDP audit will be needed in order to obtain a clean external audit opinion for 1999.</i>
Provide input for choice of auditor and recommend terms of reference	May 15 – Jun 10	<i>Provided --- see terms of reference attached in Attachment 7.</i>
Monitor audit work	July 12–Nov 30	<i>Not begun. Auditor not selected. However, this is anticipated by early August.</i>
Ensure preparation of 3 year financial projections for business plan (see below)	Oct. 15- Nov 30	<i>To be completed as part of TOR for audit firm.</i>
Prepare interim and final reports assessing progress / status for institutional strengthening component	May 15 – Nov 15	<i>Interim or progress report provided.</i>
MICRO FINANCE ACTIVITIES	May 15-Nov 30	<i>Initial meetings held with counterparts at the mutualists' association, 2 commercial banks, NGO's, and a multilateral donor. Information received and evaluated. Strategy to be discussed by team and with USAID in October.</i>
Input for business plan about market and strategy	Oct 15-Nov 30	<i>To be provided as scheduled.</i>
Communicate with organizations and counterparts interested in micro finance and provide input and advice to USAID with respect to counterpart opinions as they might affect activities or strategy for the CEM and its institutional development.	May 15-Apr 16	<i>Contacts established. Advice to be provided to USAID in this respect.</i>
TRAINING OF CEM MANAGEMENT AND BOARD		
Summary training plan	July 28	<i>See Attachment 8 for Summary Plan.</i>

Ongoing training as part of advisory work	May 15–Nov 30	<i>Ongoing training for the CEM in the areas of financial management and accounting, governance and legal issues, and share valuation and structuring, has been a significant part of the team's approach and efforts.</i>
Training in governance and general management in an SA legal environment (2-3 days)	Oct 15– Oct. 31	<i>To be completed.</i>
Training in principles of financial management and control (3 days)	Oct 1 –15	<i>To be completed.</i>
Other training session to be decided	Oct – 15 - 31	<i>Preliminary thought is to include training in general principles of credit and risk management as a third topic to be offered during a 2-3 day training session in October.</i>
Assist CEM with Sale of Shares to the Public	May 15 – Oct 31	<i>Concepts about the structuring and valuation of a share offering and privatization have been considered. Valuation basis and strategy have been decided..</i>
Identify all legal and regulatory items required for satisfaction for sale of shares and assist CEM Board of Directors	May 15- June 2	<i>This was not completed as scheduled due to travel constraints of a team member but was addressed in July with CEM management and the head of the CEM Board. All items have been identified.</i>
Recommend business strategy for CEM, esp. re. micro-finance services and definition of market for business plan	Sept 15- Sept 30	<i>To be completed.</i>
Draft "Notice" for public offering and accompanying business plan or prospectus	Oct 31	<i>It is unlikely that there will be a public offering in Madagascar in accordance with our consensus about strategy, rather a private placement on a negotiated basis with one or more strategic investors, and the sale of shares to employees.</i>

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3. SERVICES PROVIDED

The Chemonics team provided advisory services as well as draft legal documents to Malagasy counterparts primarily at the CEM, the Ministry of Finance, and the CSBF. In addition to advice, a practical, results-oriented approach was taken, with assistance provided in implementing recommendations. Moreover, communication and coordination was initiated with other donor entities in the micro-finance area. Specific services are as follows:

- Advice to the CEM and officials at the Ministry of Finance about the legal status of the CEM, which included collaboration in the preparation of new draft legal documents of practical benefit for submission to Parliament.
- Advice to the CEM about strategy for future business activities, privatization, share valuation and structuring.
- Assistance internally at the CEM in addressing exceptions in the Delta audit report as well as other issues of concern to the team. In this part of its work the team took a very aggressive and pro-active role in correcting operational items in collaboration with CEM counterparts. The importance of managing the audit process was emphasized and training and knowledge was imparted throughout.
- Communication and coordination with other donor agencies in the area of micro-finance and micro-credit.

A list of counterpart contacts may be found in Attachment 4.

4. RESULTS OBTAINED

In furtherance of USAID's objectives the following results were obtained:

- CEM's legal status was clarified and a consensus achieved about a new legal framework for it. Enabling legislation is due to be submitted to Parliament in September or October.
- Corrective actions were taken to address concerns raised in the Delta audit report.
- Further recommendations were made to improve institutional soundness that were accepted by CEM management. These have either have been implemented, or will be implemented, with the assistance of the team.
- New measurements of profitability / sustainability were devised and accepted by CEM management and submitted to USAID for review.
- CEM's tax status was researched and a preliminary opinion was obtained that will have material effect on the project.

With respect to the RFP, results specified in Sections B and C have been largely attained. Progress has also been made in realizing the results specified in Sections A and D, and initiatives have been taken to help assure the result set forth in Section E. Below are excerpts from the RFP about results specified, with comment about status related to each item:

RFP Result

"The contractor shall focus on assisting the CEM in clearing up all ambiguities regarding the organization's legal status. In particular, the contractor will provide technical leadership in assisting the CEM to complete its transition to an independent company (Societe Anonym or S.A.) as authorized by Law 95/019. In doing so, the contractor will take every reasonable measure to ensure that, by the end of the contract, the CEM has:

- a fully functioning board of governors with appropriate private sector representation;*
- clear legal status; and*
- adequate financial capital to sustain its operations."*

Comment

Significant progress has been made in clarifying legal status and positioning the CEM for private investment. A fully functioning board of governors (or directors in corporate nomenclature) cannot occur until the CEM is transformed into a société anonyme with by-laws that define the functions and empower the tenure of such a board. The Chemonics team does not consider that there is a lack of financial capital to sustain CEM's operations, as the institution is adequately capitalized for its business in relation to international norms and possesses reasonable financial liquidity at this time based upon financial information reviewed; however, there are resource constraints that relate to critical success factors for the CEM's future sustainability that should be considered and are mentioned in Section 5 (below) of this report.

In the process of this work, the contractor will carry out the following (illustrative) tasks:

RFP Result

A. *"Assist the CEM in bringing its corporate governance into accordance with international norms and best practices.*

** Result: Fully functioning board of governors.*

** Indicator: Periodic Board meetings initiated, and ownership is structured so that the private sector is represented.*

** Result: Adoption by the CEM of measures and practices to improve corporate management and profitability.*

** Indicators:*

** All selected recommendations of the Diagnostic Report of September 1999 (Annex 1) and of the USAID-funded 1999 Financial Audit and Internal Control Review of the CEM by Delta Audit (Annex 2) are addressed and closed, as appropriate.*

** An internal audit function is incorporated into routine governance of the institution that meets the requirements of relevant regulatory bodies, international norms and best practices.*

** High-quality quarterly financial statements suitable for public dissemination are produced.*

- Procedures are established that include external audits as part of the administrative policy."*

Comment

A fully functioning board of directors is not in place with regular meetings and would not be, until transformation to an S.A. occurs with appropriate by-laws that empower such a board of directors. However, training will be conducted for current board members of the EPIC in anticipation of the transformation. New measures and practices to assist with better management have been recommended to the CEM and a pro-active role taken in their implementation. Many of the recommendations of the Delta audit and additional issues raised by the team have been addressed and implemented. A first step has been taken by the CEM toward an audit function by setting up a control area reporting to the director of finance; the team will assist the CEM in taking the next step to occur upon transformation to a société anonyme. Quarterly financial statements run off a general ledger need to be better developed; this will depend upon further progress in the application of accrual accounting principles internally and efficient internal interface with the general ledger accounting system. Assistance in these areas is process. An annual external audit should be required, and an audit for 1999 should be in preliminary form by mid-October (see below Section 5).

RFP Result

B. *“Assist the CEM in institutionalizing improved financial management methods for long term profitability. This would include reviewing the realism of established indicator targets for growth in clients and deposits, and assisting USAID and CEM in selecting an appropriate profitability/sustainability indicator to track the CEM’s financial performance.*

** Result: Profitability analysis is institutionalized within the CEM and profitability baseline and target figures are set and tracked. Examples:*

** Return on Assets, i.e. $(\text{Net income after tax} \times 100) / \text{Average Total Assets}$ is greater than 1% per year.*

** Return on Equity Capital (%), i.e. $\text{Net Income After Taxes} \times 100 / \text{Average Equity Capital}$ is greater than 15%.*

** Indicator: Periodic reporting on a selected profitability indicator to the board of governors is begun.”*

Comment

New measurements that differ from the examples above have been devised that are relevant to CEM’s status and possibilities. These have been reviewed by CEM management, recommended for consideration to USAID, and could be reported to the Board, if approved.

RFP Result

C. *“Analyze the tax implications of transforming the CEM into an S.A. This should include the tax treatment of clients’ interest as well as the probable impact on the CEM’s profitability and/or sustainability.*

** Result: Probable impact of the introduction of taxes on the institution’s sustainability is clearly presented for consideration by the CEM and USAID.*

** Indicator: Production of an analysis that projects financial statements under the two alternative tax scenarios (S.A. and EPIC).”*

Comment

A tax preliminary opinion has been obtained from qualified local counsel and the implication of this has been incorporated into a white paper about profitability / sustainability submitted to USAID (see Attachment 5 hereto). Unlike other EPIC's, EPIC-CEM has not paid income taxes and believes that this can be justified based upon its public service function; however, according to our review, possible liability does exist for back income taxes for a maximum of three years that would have a material effect on the CEM's financial condition, investor interest, and any external audit report. We are in the process of including this issue for treatment in the new law in order to resolve it at the political level in the context of CEM's transformation into a société anonyme (see Attachment 2 to this report).

Financial projections or modeling utilizing the two alternative tax scenarios would only be relevant if one assumes that the CEM does not owe income tax as an EPIC. If one assumes that its income is taxable, there would be no difference financially, as rates are the same.

RFP Result

D. *“Assist the CEM in institutionally strengthening the CEM's accounting system/practices to ensure that it is capable of producing periodic financial reports that meet the norms of the International Accounting Standards Committee (IASC).*

1. *Assist the CEM in upgrading its accounting system/practices.*

* *Result: Authoritative quarterly financial statements are produced for review and approval by the Board of Governors utilizing the Commission de Supervision Bancaire and Financiere (CSBF) “Plan Comptable des Etablissements de Credit” as the basis for corporate accounting.*

* *Indicator: A parallel accounting system introduced that accommodates CEM's comprehensive changeover/conversion to the CSBF's "Plan Comptable des Etablissements de Credit" without impacting or disrupting other operational systems.*

* *Result: In accordance with generally accepted accounting principles, CEM's accounting system accommodates the impact of PTT management over CEM's rural client transactions.*

* *Indicator: Means established (not to exclude the possibility of outsourcing) for provisional accounting of Post Office Branch/window transactions.*

2. *Provide input into the selection of the audit firm, and terms of the audit contract, for the 1999 audit exercise.*

* *Result: A competent audit firm is contracted by CEM to perform an independent audit for the 1999 exercise.*

* *Indicator: The Statement of Work for the audit contract is developed collaboratively by the contractor and CEM.*

3. *Monitor and review the quality control of the audit work itself to ensure that the audit meets Generally Accepted Auditing or other standards promulgated by the International Auditing Practices Committee of the International federation of Accountants(IFAC).*

* *Result: Audit of CEM.*

* *Indicators: Timely receipt of an acceptable audit report.*

* *Result: Validation of data and collection methods for reporting on USAID/CEM indicators (e.g. setting acceptable level of measurement error under SR 1.1.2).*

* Indicators: Documentation of validation procedures for current USAID/CEM indicators. Performance of a financial audit that meets international norms, complies with the provisions of Law 96/020 and makes recommendations about accounting for the sale of CEM shares."

Comment

See Attachment 3 for extensive description about the work and results relating to this section of the RFP. Substantial progress has been made but more remains to be done; however, the CEM needs an external audit by a qualified international firm for 1999 but faces resource constraints (see Section 5 below about "Critical Success Factors.")

RFP Result

E. "Assist the Conseil d'Administration in reviewing legal requirements, procedures and strategies for the sale of CEM's shares to the public, and in carrying out the sale. The contractor shall establish a well-documented, rational basis for asset restructuring and share valuation, perform due diligence and mediate in negotiations among concerned parties to ensure that solutions are found to any hindrances to the finalization of the sale of CEM shares.

* Result: Completion of the sale of fairly valued CEM shares to the public in a transparent manner and in accordance with Law 95/019, as appropriate.

* Indicators: Production of the required public notice and a prospectus for the sale of the shares. Definitive constitution of the CEM as a S.A. as evidenced by the sale of all offered shares."

Comment

Assistance in this area has begun with work on a privatization strategy and a business plan and review of required procedures for a prospectus. A preliminary basis for share valuation has been decided (book value). Final work in this area is scheduled for completion in October – November. It is uncertain that a transaction can be executed for the sale of shares during the term of this contract, as the timing of this is beyond the control of the Chemonics team.

We understand USAID has revised certain language in this section of the RFP to ensure that Chemonics could not be construed as acting as an intermediary or broker-dealer under U.S. securities laws but would be furnishing materials and knowledge as consultants for use by the CEM and / or its agents. Also it should be noted that Chemonics' activities appear to be subject to the privatization law in Madagascar, which will require certain additional formalities.

RFP Result

"Legal transformation work in completing the definitive constitution of the S.A. would also include assisting the CEM in adopting corporate goals (social objectives) compatible with those of USAID/Madagascar's Country Strategic Plan."

Comment

Close coordination with USAID is intended throughout the duration of the contract. In particular, a white paper was submitted for discussion about general issues and concepts, and a business plan,

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which will be the basis for both a license application and solicitation of investment, will be submitted to USAID for review and approval before release to Malagasy counterparts, in order to ensure consistency with USAID's Country Strategic Plan.

5. CRITICAL SUCCESS FACTORS FOR THE CEM

There are five critical success factors that USAID should take into account in consideration of continuing support for the CEM. All five of these factors either are being pursued or could be addressed in the future.

- 1. TRANSFORMATION INTO A SOCIÉTÉ ANONYME AND CONSENSUS ABOUT PRIVATIZATION / LIBERALIZATION STRATEGY.**
- 2. APPROVAL OF A LICENSE AS A SPECIALIZED FINANCIAL INSTITUTION.**
- 3. INDEPENDENCE OF MANAGEMENT AND CAPACITY-BUILDING IN OPERATIONS, CREDIT MANAGEMENT, AND SYSTEMS.**
- 4. AN UNQUALIFIED AUDIT OPINION FROM AN AUDIT FIRM IN ACCORDANCE WITH INTERNATIONAL STANDARDS.**
- 5. AN INTEGRATED AND AUDITABLE SOFTWARE PACKAGE APPROPRIATE FOR A THRIFT INSTITUTION.**

The first two factors are dependent upon the political will of Malagasy authorities, which appears to be present at the time of the writing of this report. Factors # 3 and 5 will require additional resources to address over the medium term. Resources required for #5 would be substantial.

With respect to the audit (point #4), it should be emphasized that in the French system companies (and state entities) have a "commissaire aux comptes," who is appointed by the Board in accordance with the by-laws, and whose function is to certify the accuracy of annual accounts to the Board. The accounts so certified as accurate may not conform to accounting standards as generally applied. The function of the commissaire aux comptes is therefore different from that of an external auditor, whose mandate would be an audit in conformity with international generally accepted accounting standards. For the CEM, annual external audits with unqualified opinions are a critical factor for consideration of continuing donor support, as well as for the attraction of private investment related to CEM's privatization.

6. NEXT STEPS

Next steps will consist of Phases 3 and 4 related closely to the Work Plan (see Section 2 above). During phase 3 in October when the entire Chemonics team is expected to be in Madagascar, we will concentrate on final steps to complete clarification of the legal framework for the CEM and the submission of all new legal documents; follow-up and assistance on measures recommended for internal strengthening of operations; three formal training sessions in accordance with the summary training plan; completion of a business plan / information memorandum and banking license application; consensus with USAID about strategy; and final structuring of CEM's privatization and a share issue. A status report will be submitted to USAID at the conclusion of this trip. Phase 4 of the work will entail implementation and follow-up as well as the drafting of the Completion Report. Legal steps as they are required of us during this process,

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consistent with the privatization law, will be observed. It would also be useful to ensure that Chemonics be approved by the Malagasy Privatization Committee as the technical adviser to CEM for some or all of the transaction (see Memorandum in Attachment 9).

Throughout this assignment, the Chemonics team will continue to take a dynamic and results-oriented approach --- creating opportunities for improvement, advancing recommendations, and assisting with their implementation once counterpart consensus has been achieved. Ongoing tasks will also be flexibly adapted to actual events as they evolve on the ground in Antananarivo, while remaining consistent with the Work Plan and RFP.

Madagascar – CEM Legal Check List

Creation of the SA-CEM

Prepare new law replacing the 1995 law no 95-019
Prepare implementing Decree for the Government
Prepare Statutes (charter, by-laws) for the SA-CEM – to be approved by MoF and CSBF
Designation of State director by the MoF
Balance Sheet of the EPIC-CEM, certified by statutory auditors
Tax issues – past income taxes, future income taxes
Tax issues – ICRM tax on depositors' interest received from CEM
Prepare (in advance) Minutes of initial General Meeting of Shareholders
SA-CEM shareholders register
SA-CEM minute book
Registration of SA-CEM in Commercial Register
Designation of two (2) Directors General for SA-CEM (pursuant to CSBF requirement)
Resolutions concerning authority delegated to Director Generals
Determine minimum capital for SA-CEM required by CSBF
Set up opening balance sheet of SA-CEM

Banking License

CSBF to approve statutes of SA-CEM
Prepare application to CSBF for banking license
Collect background information on private shareholders
Provide CSBF with constituent documents – charter, commercial registry, names of DGs
Financial statements for past three years
Business Plan – as per CSBF Instruction – pre approved by USAID

Privatization

Statement from Privatization Committee concerning USAID tender procedures for selecting Chemonics for current project (so Chemonics can be “organe technique”)
Business Plan
Cahier des Charges (procedures for privatization)
Information Memorandum
1999 financial statements audited by international auditors
Recent financial statements certified by statutory auditors

Note – The Business Plan needs to be prepared by the Chemonics team and then reviewed and agreed by – the following order – USAID, DG of the CEM, MoFE, CSBF, Privatization Committee.

ATTACHMENT 2

LAW N° 2000-_____

Providing for the formation of the
Malagasy Savings Fund Corporation
[“Société Anonyme Caisse d’Epargne de Madagascar”]

The National Assembly has adopted during its session on _____ 2000, and

The President of the Republic,

[In view of Law n° 2000-_____ of _____ 2000 relating to commercial companies,]

In view of Decision n° _____ of _____ 2000,

Promulgates this law that provides as follows:

Article 1. – *Corporation*: A Corporation [the Malagasy and French legal form is a “société anonyme”] is hereby formed that will take over the activities of the Malagasy Savings Fund [“Caisse d’Epargne de Madagascar”], an entity established in 1918 that became an industrial and commercial public enterprise [“établissement public à caractère industriel et commercial”] (EPIC) pursuant to Decree n° 85-061 of 6 March 1985. The name of the Corporation is “Malagasy Savings Fund Corporation” [“S.A. Caisse d’Epargne de Madagascar” or SA-CEM] and has “CEM” as its logo. The Corporation will be governed, subject to contrary provisions of this law, by the laws and regulations in effect in Madagascar concerning commercial companies.

Art. 2. – *Capital*: The capital of the Corporation will be fixed in its Charter [“statuts”]:

1. At the time of the formation of the Corporation, the capital of the SA-CEM will be equal to the contributions in kind and/or in cash of the State. These contributions will be represented by an amount in cash attributed to the State that will be determined by the value of the equity capital as shown on the balance sheet of the EPIC-CEM, the date of which and the procedures of transfer will be fixed by decree. In accordance with Article 6 of Law n° 96-011 of 13 August 1996, as amended, concerning the divestiture of the State from public enterprises, the State will be the sole shareholder in the Corporation on a transitional basis.

2. The share of the State in the capital of the Corporation will be reduced in one or several stages in accordance with the provisions of Law n° 96-011 of 13 August 1996, as amended, concerning the divestiture of the State from public enterprises:

- by sale of a portion of its shares in tranches to the private sector; and/or
- by increases in the capital of the Corporation in tranches upon resolution of the General Meeting of Shareholders accompanied by an issuance of new shares to the private sector to be paid for in kind and/or in cash.

Art. 3. – *Mission:*

1. The State recognizes that the Fund has a purpose that is of vital public interest and will continue to play a preponderant role in the economic and social development of Madagascar, especially through its activities in the area of saving aimed at a special clientele that would not otherwise have access to financial and banking services. In this context, the Fund will continue to serve its base clientele, namely small and medium, rural and urban savers.

2. The Fund will have as its purposes to:

- promote individual saving and education about saving;
- contribute to economic and social development;
- get income from the funds collected;
- make a range of financial services available to the public;
- participate in the financial markets.

3. To accomplish these purposes, it has as objectives, within the scope of its license from the Commission for Banking and Financial Supervision (CSBF), to:

- receive funds from the public;
- grant short, medium and long term credits for the financing of individual and community projects of an economic nature;
- make investments in all types of existing and future financial institutions;
- and, generally, to undertake banking, financial, commercial, personal property and real property operations further to its license.

4. In order to safeguard and secure the funds of savers deposited with the Fund, the extension of credit and the investment of the funds from the public will be done in adherence to prudent standards.

Art. 4. – *Scope of activities:*

1. In connection with its banking and financial activities, the Fund is required to comply with the provisions of Law n° 95-030 of 22 February 1996 relating to the activity and supervision [the French word “contrôle” means review or supervision, not manage] of credit enterprises and all texts [laws, regulations] that may complete or modify such regulation.

2. The Fund will maintain its activities in the area of savings, and the Fund may continue all of its present activities as authorized by Decree n° 85-061 of 6 March 1985 providing for the organization of the Malagasy Savings Fund, until the receipt of its license from the Commission for Banking and Financial Supervision (CSBF). Such license will confer on the

Fund the power to carry out operations of a banking and financial nature for the benefit of individual persons and public and private legal entities.

3. The Fund may be licensed by the Commission for Banking and Financial Supervision as a specialized financial institution authorized to undertake activities in the micro-finance area and to receive deposits of less than a two-year term.

Art. 5. – *Charter:* The General Meeting of Shareholders will adopt the Charter of the Corporation, which will, subject to contrary provisions of this law, comply with the law on commercial companies.

Art. 6. – *Board of Directors:*

1. At the time of the formation of the Corporation, the Board of Directors will be composed of seven (7) members nominated by the State.

2. The Board will be modified when the private sector acquires a share in the capital of the Corporation. As long as the State owns fifty per cent (50%) or more of the capital, the Board will be composed of ten (10) members, of which:

(1) Seven (7) members nominated by the State, among whom at least two (2) must be competent in banking and financial matters.

(2) Three (3) members nominated by the private sector shareholders, among whom at least two (2) must be competent in banking and financial matters.

3. As from the date when the shareholding of the State in the capital of the Corporation goes below fifty per cent (50%), the number of directors and the composition of the Board of Directors will be fixed in the Charter. The mandate of the existing Board of Directors will end, and it will be replaced by a new Board.

Art. 7. – *Tax Provisions:*

1. In view of the provision of Art. 3, paragraph 1 above, as long as the State owns fifty per cent (50%) or more of the capital of the Corporation, the income [interest] on deposits paid by the Fund will continue to benefit from the tax exemptions applicable in respect of the activities of the EPIC-CEM.

2. Even though the EPIC-CEM as public entity of special type was not subject to the corporate income tax (or IBS) provided for in Art: 01 01 02 of the General Tax Code, the CEM will be subject thereto after its formation as a corporation [“société anonyme”].

3. The contributions in kind and in cash of the State at the time of the formation of the Corporation, as well as the sale by the State of shares in the Corporation, will be exempt from registration duties provided for in Art. 02 02 32 and following of General Tax Code.

Art. 8. – *Relationships*: The savings and banking operations of the Fund may be carried out through the Post or through any other entities chosen by the Fund.

Art. 9. – *Formal Establishment*: The Director General of the EPIC Malagasy Savings Fund shall be responsible, as founder, for carrying out the various formalities for the formation of the Corporation in compliance with the provisions of the law on commercial companies.

Art. 10. – *Transitional Provisions*: Decree n° 85-061 of 6 March 1985 concerning the organization of the Malagasy Savings Fund will continue to govern the Fund until its formal formation as a corporation.

Art. 11. – *Contrary Provisions*: All provisions [laws, regulations] contrary to this law are and will remain abrogated, in particular Law n° 95-019 of 18 September 1995 containing the charter of the Malagasy Savings Fund Corporation.

Art. 12. – *Regulations*: Regulations will provide, to the extent necessary, for the means for implementing this law.

Art. 13. – *Publication and Execution*: This law will be published in the *Official Journal* of the Republic. It will be executed as a law of the State.

DECREE N° 2000-_____

Providing for the implementation of Law N° 2000-_____ establishing the Malagasy Savings Fund Corporation ["Société Anonyme Caisse d'Epargne de Madagascar"]

The President of the Republic,
The Prime Minister, Head of the Government,
The Minister of Finance and the Economy,

In view of Law N° 2000-_____ of _____ 2000 establishing the Malagasy Savings Fund Corporation ["Société Anonyme Caisse d'Epargne de Madagascar"],

[In view of Law N° 2000-_____ of _____ 2000 on commercial companies,]

[etc.]

DECREES:

Art. 1. – *The State as Shareholder:* The Director General of the Treasury shall represent the State as shareholder in the Malagasy Savings Fund Corporation (CEM).

Art. 2. – *Charter:* The Minister of Finance and the Economy shall be competent, in the name of the State, to approve the Charter ["Statuts"], as well as any amendment or modification to such Charter, of the Malagasy Savings Fund Corporation to be proposed at the initial General Meeting for eventual approval.

Art. 3. – *Capital of the Corporation:*

At the time of the formation of the Corporation, the equity capital will be at least equal to the contributions in kind and in cash of the State resulting from the value of the equity capital of the Industrial and Commercial Public Enterprise Malagasy Savings Fund (EPIC-CEM) of which the value will be specified in the balance sheet established as of 31 December 1999 [30 June 2000] and certified by the Statutory Auditors.

The equity capital of the Corporation, belonging entirely to the State, will be allocated between the following accounts:

(1) The nominal capital of ten billion Malagasy Francs (Fmg 10,000,000,000) divided into one hundred thousand (100,000) shares of one hundred thousand Malagasy Francs (Fmg 100,000) each, allotted to the State and fully paid.

(2) A reserve pursuant to the Chart of Accounts to which will be credited any balance of the equity capital of the EPIC-CEM that will not have been credited to the nominal capital.

In accordance with Article 6 of Law n° 96-011 of 13 August 1996, as amended, concerning the divestiture of the State from public enterprises, the State will be the sole shareholder in the Corporation on a transitional basis.

Art. 4. – Divestiture by the State:

1. After the formation of the Corporation, there will be a partial divestiture by the State, in accordance with Law n° 96-011 of 13 August 1996, as amended, concerning the divestiture of the State from public enterprises, to reduce its shareholding in the capital of the Corporation to seventy per cent (70%).

(1) This divestiture will be accomplished by an increase in the capital of the Corporation by resolution of the General Meeting of Shareholders with a view to issuing new shares to the private sector for cash.

(2) The nominal capital will be increased by contributions in cash and/or in kind of four billion two hundred eighty million Malagasy Francs (Fmg 4,280,000,000) by the private sector, divided into forty-two thousand eight hundred (42,800) shares of one hundred thousand Malagasy Francs (Fmg 100,000) each, fully paid.

(3) The new nominal capital of the Corporation, after this increase, will be brought to fourteen billion two hundred eighty million Malagasy Francs (Fmg 14,280,000,000) and allocated between the State which will own seventy per cent (70%) and the private sector which will own thirty per cent (30%).

2. The ordinary shares to which private investors will subscribe may be issued at their nominal [par] value increased by an issue premium upon the increase in capital. This price as well as the other terms and conditions of the issuance of such shares will be established pursuant to Law n° 96-011.

3. In parallel, the Corporation shall have the possibility to issue preferred shares, to the extent permitted by the law on commercial companies, to all or some of the subscribers, of which the price, terms and conditions of issuance will be determined as provided in the previous paragraph.

Art. 5. – Board of Directors:

1. The seven (7) members of the Board of Directors of the Corporation nominated by the State pursuant to the provisions of Article 6, paragraph 1 and paragraph 2 (1), of Law n° 2000-_____ of _____ 2000 establishing the Malagasy Savings Fund Corporation shall be:

[To be completed by the Ministry of Finance and the Economy]

2. The three (3) members of the Board of Directors of the Corporation nominated by the private sector shareholders pursuant to the provisions of Article 6, paragraph 2 (2), of Law n° 2000-_____ of _____ 2000 shall be designated by a special meeting of the future shareholders from the private sector who have subscribed to shares for cash pursuant to the provisions of Article 4 above.

Art. 6. – *Execution:* The Minister of Finance and the Economy is charged with the execution of the implementation of this decree, which will be published in the *Official Journal* of the Republic.

LOI N° 2000-_____

Portant création de la Société anonyme
Caisse d'Epargne de Madagascar

L'Assemblée Nationale a adopté en sa séance du _____ 2000, et

Le Président de la République,

[Vu la Loi n° 2000-_____ du _____ 2000 relative aux Sociétés commerciales]

Vu la Décision n° _____ du _____ 2000,

Promulgue la loi dont la teneur suit:

1.

Article premier. – *Société Anonyme* : Il est créé une Société anonyme qui reprendra les activités de la Caisse d'Epargne de Madagascar, établissement créé en 1918 et devenu un établissement public à caractère industriel et commercial (EPIC) par le Décret n° 85-061 du 6 mars 1985. La Société porte le nom de « S.A. Caisse d'Epargne de Madagascar » et a pour sigle « CEM ». La Société sera régie, sauf dispositions contraires de la présente loi, par les textes en vigueur à Madagascar sur les sociétés commerciales.

Art. 2. – *Capital Social* : Le capital social de la Société sera fixé dans ses Statuts :

1. Au moment de la constitution de la Société Anonyme, le capital social de la SA-CEM sera égal aux apports en nature et/ou en numéraire de l'Etat. Lesdits apports seront représentés par un montant en numéraire attribué à l'Etat qui découlera de l'évaluation des capitaux propres tels qu'ils sont arrêtés au bilan de l'EPIC-l'EPIC-CEM dont la date et les modalités du transfert seront fixées par décret. Conformément à l'article 6 de la Loi n° 96-011 du 13 août 1996 et ses modificatifs portant désengagement de l'Etat des entreprises publiques, l'Etat sera le seul actionnaire de la Société à titre transitoire.

2. La part de l'Etat dans le capital social de la Société sera réduite en une ou plusieurs étapes conformément aux dispositions de la Loi n° 96-011 du 13 août 1996 et ses modificatifs portant désengagement de l'Etat des entreprises publiques :

- par cession de ses actions au secteur privé réalisé par tranche ; et/ou
- par augmentation du capital social de la Société réalisée par tranche sur décision de l'Assemblée générale des actionnaires accompagnée d'une émission d'actions nouvelles à libérer en nature et/ou en numéraire au secteur privé.

Art. 3. – *Mission* :

1. L'Etat reconnaît que la Caisse est investie d'une mission permanente d'intérêt public et continuera à jouer un rôle prépondérant dans le développement économique et social de Madagascar, notamment à travers ses activités dans le domaine de l'épargne envers une clientèle spéciale qui n'aurait pas accès autrement aux services financiers et bancaires. Dans ce cadre, la Caisse continuera à servir cette clientèle de base, notamment les petits et moyens épargnants ruraux et urbains.

2. La Caisse aura pour missions de :

- promouvoir l'épargne individuelle et l'éducation à l'épargne ;
- contribuer au développement économique et social
- faire fructifier les fonds collectés ;
- mettre à la disposition du public une gamme de services financiers ;
- participer aux marchés financiers.

3. Pour mener à bien ces missions, elle a pour objet, dans le cadre de son agrément de la Commission de Supervision Bancaire et Financière (CSBF), de :

- recevoir des fonds du public ;
- consentir des crédits à court, moyen et long terme pour le financement de projets individuels ou communautaires à caractère économique;
- prendre des participations dans toutes institutions financières existantes ou à créer ;
- et, généralement, faire des opérations bancaires, financières, commerciales, mobilières et immobilières découlant de son agrément.

4. Afin de sauvegarder et de sécuriser les fonds des épargnants déposés chez la Caisse, l'octroi de crédits et le placement des fonds du public se feront dans le respect des normes prudentielles.

Art. 4. - : *Champ d'activité*

1. Dans le cadre de ses activités bancaires et financières, la Caisse est tenue de se conformer aux dispositions de la Loi n° 95-030 du 22 février 1996 relative à l'activité et au

contrôle des établissements de crédit et à tout texte qui viendrait à compléter ou modifier ladite réglementation.

2. La Caisse conservera ses activités dans le domaine de l'épargne, et la Caisse peut continuer toutes ses activités actuelles telles qu'elles sont autorisées par le Décret n° 85-061 du 6 mars 1985 portant organisation de la Caisse d'Epargne de Madagascar, jusqu'à l'obtention de l'agrément de la Commission de Supervision Bancaire et Financière (CSBF). Ledit agrément confèrera à la Caisse le pouvoir d'effectuer des opérations à caractère bancaire et financier au profit des personnes physiques et des personnes morales, de droit public ou privé.

3. La Caisse pourrait être agréée par la Commission de Supervision Bancaire et Financière (CSBF) au titre d'institution financière spécialisée autorisée à intervenir dans le domaine de la micro-finance et à recevoir des dépôts à moins de deux (2) ans de terme.

Art. 5. – *Statuts* : L'Assemblée générale des actionnaires adoptera les Statuts de la Société qui seront, sauf dispositions contraires de la présente loi, conformes à la loi sur les sociétés commerciales.

Art. 6. – *Conseil d'Administration* :

1. Le Conseil d'Administration sera composé de sept (7) membres nommés par l'Etat à la constitution de la Société.

2. Le Conseil sera modifié lorsque le secteur privé participe dans le capital social de la Société. Tant que l'Etat détiendra cinquante pour cent (50%) ou plus du capital social, le Conseil sera composé de dix (10) membres dont :

(1) Sept (7) membres nommés par l'Etat, parmi lesquels deux (2) au moins devront avoir des compétences en matière bancaire et financière.

(2) Trois (3) membres nommés par les actionnaires du secteur privé, parmi lesquels deux (2) au moins devront avoir des compétences en matière bancaire et financière.

3. A partir de la date où la part de l'Etat dans le capital social de la Société passe en dessous de cinquante pour cent (50%), le nombre des administrateurs et la composition du Conseil d'Administration seront fixés dans les Statuts. Le mandat du Conseil d'Administration existant prendra fin et il sera remplacé par un nouveau Conseil.

Art. 7. – *Dispositions Fiscales* :

1. Au vu des dispositions de Art. 3, alinéa 1 ci-dessus, tant que l'Etat détiendra cinquante pour cent (50%) ou plus du capital social de la Société, la rémunération des dépôts versée de la Caisse continuera à bénéficier des exonérations fiscales applicables dans le cadre des activités de l'EPIC-CEM des dispositions des Arts. 1.01.03 et 1.02.03 du Code Général des Impôts.

2. Quoique l'EPIC-CEM comme organisme public de caractère unique ne se trouvât soumis à l'impôt sur les bénéfices des sociétés (ou IBS) des dispositions de Art : 01 01 02 du Code Général des Impôts, la CEM y sera soumise dès sa constitution en Société Anonyme.

3. Les apports en nature et en numéraire de l'Etat au moment de la création de la Société anonyme, ainsi les cessions par l'Etat des actions dans la Société, seront exonérés des droits d'enregistrement prévus à l'Art. 02 02 32 et suivants du Code Général des Impôts.

Art. 8. – *Partenariat* : Les opérations d'épargne et de banque de la Caisse pourraient être effectuées par l'intermédiaire de la Poste ou par tous autres établissements choisis par la Caisse.

Art. 9. – *Constitution Définitive* : Le Directeur Général de l'EPIC Caisse d'Epargne de Madagascar est chargé, en tant que fondateur, d'effectuer les diverses formalités constitutives de la Société conformément aux dispositions de la loi sur les sociétés commerciales.

Art. 10. – *Dispositions Transitoires* : Le Décret n° 85-061 du 6 mars 1985 portant organisation de la Caisse d'Epargne de Madagascar continue à régir la Caisse jusqu'à la constitution définitive de la Société anonyme.

Art. 11. – *Dispositions Contraires* : Toutes dispositions contraires à la présente loi sont et demeurent abrogées, notamment la Loi n° 95-019 du 18 septembre 1995 portant statuts de la Société anonyme Caisse d'Epargne de Madagascar.

Art. 12. – *Textes Réglementaires* : Des textes réglementaires fixeront, en tant que de besoin, les modalités d'application de la présente loi.

Art. 13 – *Publication et Exécution* : La présente loi sera publiée au *Journal officiel* de la République. Elle sera exécutée comme loi de l'Etat.

DECRET N° 2000-_____

Fixant les modalités d'application de la Loi n° 2000-_____
créant la Société anonyme Caisse d'Epargne de Madagascar

Le Président de la République,
Le Premier Ministre, Chef du Gouvernement,
Le Ministre des Finances et de l'Economie,

Vu la Loi n° 2000-_____ du _____ 2000 portant création de la Société anonyme Caisse d'Epargne de Madagascar,

[Vu la Loi n° 2000-_____ du _____ 2000 sur les sociétés commerciales,]

[etc.]

DECRETE :

Article premier. – *L'Etat Actionnaire* : Le Directeur Général du Trésor représente l'Etat en tant qu'actionnaire dans la Société anonyme Caisse d'Epargne de Madagascar (CEM).

Art. 2. - *Statuts* : Le Ministre des Finances et de l'Economie est compétent, au nom de l'Etat, pour approuver les Statuts, ainsi que tout amendement ou modification desdits Statuts, de la Société anonyme Caisse d'Epargne de Madagascar à être proposés à l'Assemblée constitutive pour adoption éventuelle.

Art. 3. - *Capital Social de la Société* :

1. Au moment de la constitution de la Société Anonyme, les capitaux propres seront au moins égaux aux apports en nature et en numéraire de l'Etat découlant de l'évaluation des capitaux propres de l'Etablissement Public à caractère Industriel et Commercial Caisse d'Epargne de Madagascar (EPIC-CEM) dont la valeur sera précisée au bilan arrêté le 31 décembre 1999 [30 juin 2000] et certifié par les Commissaires aux Comptes.

2. Les capitaux propres de la Société, appartenant intégralement à l'Etat, seront répartis entre les postes suivants :

(1) Le capital social de dix milliards Francs malagasy (Fmg 10.000.000.000) divisé en cent mille (100.000) actions de cent mille Francs malagasy (Fmg 100.000) chacune, attribuées à l'Etat et entièrement libérées.

(2) Une réserve conformément au Plan Comptable auquel sera affecté tout solde des capitaux propres de l'EPIC-CEM qui n'aura pas été apporté au titre de capital social.

3. Conformément à l'article 6 de la Loi n° 96-011 du 13 août 1996 et ses modificatifs portant désengagement de l'Etat des entreprises publiques, l'Etat sera le seul actionnaire de la Société à titre transitoire.

Art. 4. - Désengagement de l'Etat :

1. Après la constitution de la Société, il y aura un désengagement partiel de l'Etat conformément à la Loi n° 96-011 du 13 août 1996 et ses modificatifs portant désengagement de l'Etat des entreprises publiques pour réduire sa part dans le capital social de la Société anonyme à soixante-dix pour cent (70%).

(1) Ce désengagement sera effectué par une augmentation de capital de la Société sur décision de l'Assemblée générale des actionnaires en vue d'émettre de nouvelles actions en numéraire au secteur privé.

(2) Le capital social sera augmenté par des apports en numéraire et/ou en nature de quatre milliards deux cent quatre vingt millions Francs malagasy (Fmg 4.280.000.000) par le secteur privé, divisé en quarante deux mille huit cents quatre-vingt (42.800) actions de cent mille Francs malagasy (Fmg 100.000) chacune, entièrement libérées.

(3) Le nouveau capital social de la Société, après cette augmentation, sera ramené à quatorze milliards deux cent quatre vingt millions Francs malagasy (Fmg 14.280.000.000) et réparti entre l'Etat qui en détiendra soixante-dix pour cent (70%) et le secteur privé qui en détiendra trente pour cent (30%).

2. Les actions ordinaires auxquelles les investisseurs privés souscriront peuvent être émises à leur montant nominal majoré d'une prime d'émission lors de l'augmentation de capital. Ce prix ainsi que les autres termes et conditions de l'émission desdites actions seront établis conformément à la Loi n° 96-011.

3. Parallèlement, la Société aura la possibilité d'émettre des actions privilégiées, dans la mesure édictée par la loi sur les sociétés commerciales, à tous les souscripteurs ou certains d'entre eux, dont le prix, termes et conditions d'émission seront établis comme prévu à l'alinéa précédent.

Art. 5. - Conseil d'Administration :

1. Les sept (7) membres du Conseil d'Administration de la Société nommés par l'Etat conformément aux dispositions de l'Article 6, alinéa 1 et alinéa 2 (1°), de la Loi n° 2000-_____ du _____ 2000 créant la Société anonyme Caisse d'Epargne de Madagascar sont :

[A être complété par le Ministère des Finances et de l'Economie.]

2. Les trois (3) membres du Conseil d'Administration nommés par les actionnaires du secteur privé conformément à l'Article 6, alinéa 2 (2°), de la Loi n° 2000-_____ seront désignés

July 12, 2001

par une assemblée spéciale des futurs actionnaires du secteur privé ayant souscrit aux actions en numéraire selon les dispositions de l'Article 4 ci-dessus.

Art. 6. - *Exécution* : Le Ministre des Finances et de l'Economie est chargé de l'exécution de l'application du présent décret qui sera publié au *Journal officiel* de la République.

Financial Management Report

Follow-up on recommendations of the Audit Report of the Fiscal Year 1997 from Delta

*Assistance in implementing corrective action
May 16- June 9, 2000*

B1 General Controls --- Comment from Delta

B1/1 - Legal status unclear

Decree has not been promulgated to ensure implementation of law 95-019.

Corrective action undertaken

Upon verification, the CEM is still an EPIC, and the decree of application has still not been promulgated as of May 29, 2000. Therefore its legal status is clear --- it is an EPIC.

Assessment of the corrective action

Situation corrected. No action necessary to clarify legal status.

B1/2 - Need to rework the organizational chart

Implementation within the CEM of a "control" function that would be responsible, among other things, for internal audits.

Corrective action undertaken

The proposal from Delta dated October 26, 1999, to establish a "control" function was accepted by the CEM. The length of the work is 12 weeks, presented as a work plan. In the middle of May 2000, the position was filled with the appointment of M. Rabarisoa Solofoniaina. His training began the last week of May 2000.

Assessment of the corrective action

Situation in the process of being corrected

According to Delta, the position will be operational by the end of August. This date could be met if additional assistance is provided in the following area of more detailed procedures as well as

forms to be used throughout the budget process, i.e.: detailed tables of projected expenses and revenues, summary tables, variance analysis tables, and tables of targets and objectives.

It should be noted that the function of internal audit has not yet been started.

Other action recommended by Chemonics

The following actions should be taken in order to complete the work already started by the CEM to be able to have an operational management control body:

- Collecting data needs cooperation of all of CEM's services. Training sessions for personnel should be planned for all departments that would supply projected figures.
- Training sessions should also be organized for personnel involved in reviewing and interpreting the tables of targets and objectives.
- As far as operating expenses are concerned, as an EPIC, the CEM already has a management control system in place with the procedure of written orders for payment by central administration. It is a good budget control system because it intervenes at the point of commitments (commitment control). The CEM should consider integrating this service with the management control system.
- It is also the controller who manages, plans, and evaluates profitability of investments (capital budgeting), especially during the creation of new branches.

When the CEM decides to implement the function of internal auditing, this function should not be handled by the same staff as that of "control." The two are different: The internal auditor cannot verify that the management controller is following procedures if it is in fact the same person. It would be necessary to place the function of internal control in the department of finance, whereas the function of internal auditor might report to the office of the general manager, or even better, to the audit committee of the board of directors. The background of an internal auditor should preferably be a person with general management experience, and not necessarily an accountant. In contrast to external audits that check only accounting procedures, the internal auditor checks whether or not procedures for all services are being respected: accounting, budgeting, personnel, savings accounts... And if the CEM foresees getting into credit, a person with credit experience would be desirable for this position.

B1/3 – Management Information Flow in Real Time

In order to be able to have reliable information in almost real-time, the information management system of CEM must be updated.

Corrective action

At this time, the management programs, client information, management, and withdrawal and deposit operations, personnel management, and accounting are integrated: Manual reports are no

longer being used. Two programs that have not yet been integrated are stock management and property management.

Assessment of the corrective action

Situation corrected

Eliminating manual reports fulfills the recommendation and constitutes an improvement by reducing the incidence of errors.

Stock management and property management are not yet integrated. Integrating the software for these two purposes is not of high priority, and the current organization is satisfactory. To make up for the lack of integration, after the general ledger reports, a reconciliation needs to be made between the general ledger balances and auxiliary journals.

It should be noted also that the CEM took advantage of assistance from INODE and from a consultant named Rakotoarivelo Jacques to modify the programs, reconstituting the technical files, and user manuals.

Other action recommended by Chemonics

Passwords should be instituted to limit access to computers to authorized personnel. These passwords should be placed in a sealed envelope and given to the financial director.

With regard to managing stock and property, after annual reports from the general ledger, a reconciliation needs to be made between the balances on the general ledger and auxiliary journals. In the future, thought should also be given to quarterly reports' being reconciled, this for the purpose of producing reliable quarterly financial statements.

In Delta's report as well as in other reports related to CEM's computer system, emphasis was placed on the technological area. CEM, a savings institution, depends completely on computers to handle deposit and withdrawal transactions, treasury management, the calculation of interest to pay and to be received, data transfers by modem...CEM must assure the integrity and reliability of programs that are developed over time and make sure that integration can take place if needed. Toward this end, *an audit of all computer systems should be carried out by a specialist from a reputable audit company.*

CEM is still doing batch processing. Acquiring an online system would be a step that should not be neglected. Such a system would eliminate accounting delays and would reduce errors in batch processing (back office) and will improve the quality of customer service.

B2 Specific Controls --- Recommendations by Delta

B2/1 - *Management of savings accounts*

B2/1/1 - Use of a single liaison account for all post offices

In order to allow for tracking of transactions carried out by post offices and to thereafter facilitate tracking usage, a liaison account should be assigned to each office.

Corrective action

Deposit and withdrawal cards in post offices are sent to headquarters, which does that data entry. This entry is thereafter validated in the general ledger (posting to GL). A monthly summary report is printed out from this card index and sent to the accounting agent and the service of control of operations of the commercial department, which reconciles it with the G58 form (monthly summary) from the post office administration. There is the possibility of printing out on the basis of this card index, a monthly report from each post office with daily totals of deposits and withdrawals. It is also possible to print out all the deposit and withdrawal transactions for any given day.

Assessment of corrective action

Situation corrected

Insofar as it is possible to print out monthly and daily reports for each post office, creating an account for each post office does not result in any noticeable improvement as far as tracking transactions is concerned. The card index plays the role of the auxiliary journal.

B2/1/2 - Absence of test of existence control of movement codes at the time of posting

In order to avoid errors in calculating client credit balances, it is recommended that the computer department modify the program so that erroneous movement codes are rejected at the time of posting.

Corrective action

The program was modified in 1998

Assessment of corrective action

Situation corrected

B/2/2 - Management of procurement/stocks

B2/2/1 - Lack of a purchase order register

Using a register of purchase orders should be envisaged. Purchase orders would be entered into this register at the time the orders are placed and checked off when the goods are delivered. In addition, the numerical sequence of purchase orders can be checked to ensure that none are missing.

Corrective action

The general administrative office uses an order book with stubs: each order is made up of an original and a copy that are torn out and a stub that remains in the book. Orders are numbered. There is also a register that notes down all deliveries and invoices received. The original and one copy of the order (the ones torn out) are sent to the supplier. The copy sent to the supplier comes back attached to the corresponding invoice.

Assessment of corrective action

Situation partially corrected

The notebook with stubs, along with the register of deliveries and invoices, fulfills the recommendation.

A rather large number of invoices come in that are not generated by earlier orders. The orders are prepared when the invoices are received and the money orders to pay them are drawn up. This is due to the lack of decentralization of the accounting function linked to the EPIC status.

Other action recommended by Chemonics

To simplify the current procedure, the register of deliveries and invoices should be eliminated. In its place, this information should be noted directly on the stub copy of the order.

The absence of purchase orders for a large number of invoices is the result of excessive centralization of the present procedure: a single service for issuing purchase orders in Antananarivo for all the agencies of the CEM. Due to distances, agencies make purchases for goods and services with verbal authorization (telephone), and purchase orders are subsequently prepared to get the paperwork in order.

Since purchase orders are signed by the general manager, verbal authorizations are granted by other individuals who do not have the authority to engage the CEM, unless they have been specifically delegated such authority by the general manager.

CEM should consider decentralizing the issuance of purchase orders within the limit authorized in the EPIC framework. As the agencies grow, this problem will only get worse.

B/2/2 - Insufficient choice of printing suppliers

For goods purchased in large quantities (such as printed material), CEM should issue tenders and obtain offers from at least three different suppliers before placing the order with the most competitive supplier in terms of price, quality, and delivery time.

Corrective action

CEM today uses several suppliers.

Assessment of corrective action

Situation corrected

B/2/3 - Inadequate management of computer supplies

Stock cards should be used to better plan the management of restocking and show details about their use. Physical inventories checks should be carried out at regular intervals.

Corrective action

Computer supplies are now on stock cards and regular checks are made to avoid running out of supplies, which could be very damaging to an organization dependent on computers.

Assessment of corrective action

Situation corrected

B/2/4 - Irrational use of gas vouchers

In order to avoid abuse of gas vouchers from the CEM, drivers should prepare requests for vouchers that are checked and approved by their supervisors, before being transmitted to the person responsible for the vouchers. In addition, the car license tag numbers should appear on the vouchers issued.

Corrective action

Tracking gas vouchers has been organized two ways:

1 - For staff with the right to allowances (senior staff), vouchers are simply issued up to the amount of the allowance

2 - For services, the vouchers are noted on a notebook along with details of the numbers of the vouchers, the date, vehicle information, and the driver's signature.

Assessment of corrective action

Situation partially corrected

In addition, the odometer reading should be noted on the notebook each time vouchers are issued for services. Senior staff, who benefit from an allowance, have the privilege of discretionary use of vehicles.

Other action recommended by Chemonics

Note the odometer reading on the notebook each time a voucher is issued.

The notebook currently used is a pre-printed booklet originally intended for an entirely different use, so in practice it is difficult to adapt for this purpose. A blank register should be used with columns marked appropriately.

B/2/3 – Treasury --- Recommendations by Delta

B2/3/1 - Lack of petty cash

There is occasional lack of petty cash for operating expense purposes.

Corrective action

The CEM decided to let each agency have a petty cash box. This is possible even though CEM is an EPIC. All the accountant has to do is grant an advance. This petty cash is for the purpose of meeting small expenses (light bulbs, photocopy charges...) or to meet payments that cannot be delayed (water or electricity bills).

Assessment of corrective action

Situation in the process of being corrected

Other action recommended by Chemonics

Along with introducing a petty cash box, it should be made clear that agencies must not be allowed to use savings funds to pay operating expenses, in order to respect the principle of segregation of funds.

Operationally, the petty cash should be at a set amount:

- The accountant authorizes an advance, for example, 2 million Fmg, by sending this amount to an agency (accounting method: debit - advance to agency X, credit - current account of operating fund).

- The agency keeps this 2 million Fmg in a cash box in cash, clearly separated from savings funds.
- The agency uses petty cash to pay authorized expenses, and exchanges cash for supporting documents. At all times, the total of the cash and the vouchers should equal the advance, or in this case 2 million Fmg.
- Periodically, before the advance is completely used up (for example, when the cash falls below 1 million Fmg), the agency requests a replenishment of the petty cash (the amount equaling the total of vouchers) by sending a detailed list of expenses along with supporting documents to the accountant. After examining the account, the accountant replenishes the petty cash account by sending the amount requested, bringing the advance back up to 2 million fm (accounting method: debit - charge accounts, credit - bank).

B/2/4 - Management of Fixed Assets --- Recommendations from Delta

B2/4/1 - Lack of tracking of fixed assets

Using a register facilitates managing fixed assets. Each element should be listed with the following information:

- Code and designation of the immovable property
- Origin of the investment
- References of invoices from suppliers and the date of purchase
- Overall value
- Rate and length of depreciation
- Name of responsible holder
- Any other important information: sale, transfer...

Corrective action

Each item of fixed assets bears a three-part number: xxxx-xxx-xxxxx. The first two are to be able to locate the property, and the third designates what it is. They are all entered into an Excel spreadsheet that calculates depreciation. The total on the spreadsheet should be equal to the overall value. When there is a transfer, the number is changed.

CEM is studying the possibility of further computerizing the management of fixed assets.

Assessment of corrective action

Situation corrected

Other action recommended by Chemonics

Put transfers and other important transactions in a register.

B2/4/2 - Lack of physical inventory check

In order to better identify its fixed assets, CEM should take a physical inventory every year with the result sent to the accounting office so that the depreciation table can be updated.

Corrective action

An inventory was conducted for fiscal year 1999

Assessment of corrective action

Situation corrected

Other action recommended by Chemonics

It is accounting too -- not just general administration -- that has the responsibility of organizing physical inventory checks. The inventory check should be carried out by one employee from accounting and one from general administration.

During a physical inventory, a list of fixed assets should be printed along with their numbers, two columns "counted by" and "verified by" each of which should be checked off. The people who do the count and the verification should date and sign at the bottom of the list.

B2/4/3 - Lack of tracking of vehicle use

In order to rationalize vehicle management and ensure closer tracking of parts and supplies, the logistics service should keep the following up to date for each CEM vehicle:

- A maintenance and repair card
- A fuel consumption card
- A trip log

Corrective action

Each vehicle has its own file, where all repairs are noted. By noting the odometer reading on gas vouchers, it is possible to calculate fuel consumption. The garage foreman keeps a register noting where the vehicles go

Assessment of corrective action

Situation corrected

B2/5 - Accounting Issues --- Recommendations of Delta

B2/5/1 - Accounting practices for cash items

Accounting entries are made by CEM only at the time of payment of invoices by the accountant. In order to have an exact accounting picture at any time, the procedures for dealing with invoices should be modified. Therefore, after an invoice is received, noted by management and validated by the user, it should be sent to accounting so that it can be entered. Copies should be cancelled to avoid duplicate payments.

Corrective action

CEM, as an EPIC, should follow public accounting procedures for operating expenses: issuance of an order - authorization by the accountant - invoice - order for payment - payment. Invoices arrive in accounting after payment.

In order to follow this process, the accounting office inputs invoices paid in two entries:

1 - First, it enters the invoice as a credit to the supplier account, and the debit according to the situation. It should be noted that the date of the transaction is the invoice date, so that the invoice is entered in the right time frame.

2 - Second, it enters the payment by crediting the supplier account with the date in the books, which is the payment date.

For example, an invoice dated November 1999 and paid in February 2000 is entered in March 2000. If the 1999 fiscal year has not yet been closed by March 2000, the invoice is entered on the general ledger in the month of November as amount payable, and cleared in February 2000.

To close the books at the end of the year, if the accounting for invoices is done several months after the end of the fiscal year and all the invoices from the fiscal year are paid and entered, accounting principals "for fiscal year" are respected.

Assessment of corrective action

Situation partially corrected

Other action recommended by Chemonics

Someone must find out if unpaid invoices remain with general administration or with the accountant and enter them against supplier accounts. This is desirable especially if CEM wants to close the fiscal year rapidly.

B2/5/2 - Accounting software unable to manage third-party accounts

Necessity of checking suppliers on the basis of the general ledger to be able to get details regarding supplier balances, which involves unnecessary work.

To remedy this problem, CEM should negotiate as soon as possible with the software designer to develop a "management of third-party accounts" module and integrate it into the present accounting system.

Corrective action

Individual supplier accounts have been created. The balances are added automatically and the result is entered in the control account of the general ledger.

Assessment of corrective action

Situation corrected

B2/5/3 - Lack of use of code of accounts

Using codes of accounts would reduce the risk of error and/or amounts during posting.

Corrective action

Codes of accounts were created and put into operation in June 2000

Assessment of corrective action

Situation corrected

B2/5/4 - Explanations of accounting entries not clear

In order to make it easier to analyze accounting entries initiated by the accounting department, explanations should be as clear as possible. The accounting software allows for up to 30 characters.

Corrective action

An effort has been made to make the explanations clearer. Using a chart of accounts also contributes to this.

Assessment of corrective action

Situation corrected

B2/5/5 - Posting accounting entries without back-up.

Before posting the entries proposed by the auditors, detailed explanations should be obtained since these entries could have an impact on CEM's accounts.

Corrective action

Explanations regarding entries suggested by the auditor are noted and attached to the OD.

Assessment of corrective action

Situation corrected

B2/5/6 - Lack of compliance with the principle of a fiscal year

We recommend that CEM take care to post financial transactions in the proper financial year in order to have a reliable picture of savings accounts on the closing date

Corrective action

Revenues earned and charges accrued for a fiscal year, are entered in the asset pending account (receivables) or liability pending account (payables) to acknowledge their existence when documents are not yet available.

Assessment of corrective action

Situation corrected

C - Corrective Actions Not Mentioned in the Audit Report --- Chemonics' Observations

Over the course of his assessment and assistance to the CEM, the Chemonics team suggested other corrective actions that were not a formal part of the auditors' recommendations, but which we believe would improve internal controls.

C1 - Segregation of savings funds from other funds

In the agencies, savings funds are used to pay operating expenses. There is no strict segregation of funds. This petty cash could be a current (or demand) account.

Corrective action per Chemonics

Setting up a petty cash account will correct this problem

C2 - Document the validation of deposit and withdrawal transactions from agencies

Each day, the agencies (except for the main one) send daily transactions to headquarters via the computerized report (preceding) in hard copy and by modem. Headquarters verifies the integrity of the data sent by modem and proceeds to validate transactions on the general ledger (posting). This validation is not documented.

Corrective action per Chemonics

The report sent by the agency should be attached to the report printed by headquarters after verification of the integrity of the modem transfer; this document is thereafter verified by matching the figures. The person who checks it should write "OK" and sign the first page of the document. This document is then sent to the person who validates it. This person notes on the document the date of the validation and files it in chronological order. This constitutes the back-up document for the validation (posting).

In the case of the agency located at headquarters, it is not necessary to check the completeness of the transmission, but the report should also have the "OK" of a responsible person before being sent to the person who does the validation. As in the earlier case, this person should note on the document the date of the validation and file it in chronological order. This constitutes the back-up document for the validation (posting).

C3 - Document validation of deposit and withdrawal transactions at post offices

Post offices send deposit and withdrawal records periodically to headquarters. These records are entered into the computer and the total amount is validated (posted) in the general ledger. Each month, a summary report is sent to the accountant who compares the G58 report from the post office administration.

Corrective action per Chemonics

After the batch is entered into the computer, it should be printed out. This batch would be verified by checking off against the records to locate any errors. The records should then be added up and their totals compared with the batch totals. The person who does the verification then would attach the adding machine tape to the batch, write "OK" and sign. The document thus constituted can be given to the person who does the validation. This person would note on the document the date of the validation and file it in chronological order. This can then constitute the back-up document for validation (posting).

C4 - Document validation of treasury transactions

Hand-written cash accounts from the agencies are sent to the treasury service at headquarters that enters them into the computer and validates (posting) them at the same time. Insofar as these hand-written documents are back-up documents, their entry into the computer and their verification should be documented.

Corrective action per Chemonics

When the hand-written cash accounts are received, they should be checked by a responsible person who notes "OK" and signs the documents and then gives them to be entered into the computer. The person who does the data entry should sign the documents, so that the same document will not be entered several times.

C5 - Centralize procedures manuals

Procedures manuals are scattered throughout various services. There is no procedure in place for updating them. This situation is not ideal, but is not problematic if the CEM has a single location. However, with agencies multiplying across the country, for reasons of control, each agency should respect the same directives, use the same procedures, and operate in the same way.

Corrective Action per Chemonics

All procedures manuals should be centralized: accounting, administrative, personnel...in a single service that becomes responsible for keeping them, distributing them, and updating them. This service keeps the updated manuals (along with all the updates). Internal auditing is the service where these manuals should go.

C6 - Rotation of personnel in the agencies

So that directives and procedures are respected in a uniform manner throughout all the agencies, employees should be rotated among different agencies.

Corrective action per Chemonics

A rotation policy is necessary but can be expensive. For it to be a success, it should be planned well in advance.

C7 - Reflection about decentralization of authority to the agencies.

Dysfunctions noted: no purchase orders, lack of segregation of savings and operating funds... resulting from the creation of new agencies in the past two years.

Corrective action per Chemonics

The creation of new agencies is a success as far as market penetration goes. CEM should match this success by thinking seriously about decentralization, so that operational problems can be avoided while maintaining essential controls in place.

C8 - Corrective actions within CEM agencies

During the visit to the agency at Antsirabe, the following points were brought to the attention of headquarters. These comments apply to most agencies.

C8.1 - Procedures manual

A bound 21-page procedures manual exists. This manual is written in Malagasy and deals with savings, closing, and reporting. As far as it goes, the manual is satisfactory. It is supplemented by photocopied pages that the agency head received during seminars.

Corrective action per Chemonics

A manual should be created for the agencies, which deals not just with savings operations, but with all aspects of the agency's work: personnel, procurement, petty cash... This manual should be in loose-leaf format so that it can be easily updated.

C8.2 - Amount of the cash balance

The cash balance at the Antsirabe agency is 176 million Fmg, of which 40 million are in outdated currency that needs to be exchanged at the Central Bank.

The net balance of daily transactions (withdrawals and deposits) does not exceed 30 million Fmg. To this should be added Western Union transactions. It is also possible to get cash from the local bank. Taking all these factors into account, a constant cash balance of 100 million should be sufficient.

Corrective action per Chemonics

An analysis should be carried out for the purpose of keeping a cash balance sufficient for normal obligations. An excessively large balance should not be kept for unusual situations, since money may be gotten from the bank. A minimum cash balance limits exposure to possible operating losses.

The outdated bank notes should be exchanged immediately at the Central Bank.

C8.3 - Bank account

There is only one bank account with the head of the agency as sole authorized signatory.

Corrective action per Chemonics

To respect standard internal control procedures, double signatures should be instituted.

The agency should also have a current operating account in order to better segregate funds

Review of the 1997 Opinion of Delta for the CEM

Qualified opinion with three exceptions

The three exceptions to the financial statements for the fiscal year 1997 result in a qualified opinion. CEM should take steps to correct these three exceptions in order to avoid a qualified opinion during the next audit.

First Exception: Lack of Separating Fiscal Years in Accounting for Interest Paid to Savings Accounts.

Because of a delay of several months receiving accounts from PAOMA (Post Office), CEM cannot calculate interest on accounts held by PAOMA.

The delays exist in all their activities. It is not for this reason that audited companies receive qualified opinions when they are unable to obtain back-up documents in time. That is why pending accounts exist to take these unavoidable delays into account. The Delta associate is ready to lift this restriction if reserve account is included with estimated amounts pending receipt of the documents (note: it is nonsensical, for example, to postpone the audit of a fiscal year for several months in order to get back-up documents together, in an effort to avoid a qualified opinion --- which is a serious matter).

For good accounting purposes, CEM should systematically calculate provisions for interest receivable and interest payable by creating accounts for this purpose. These accounts are zeroed out when the actual amounts are obtained. To produce monthly financial statements that closely reflect reality for financial controls, these calculations are obligatory.

Second Exception: Absence of physical inventory of office supplies, passbooks, and printed material.

The absence of a physical inventory of products used in manufacturing products for sale, or products purchased to be resold, automatically raises doubts about the cost of merchandise sold and the amounts of margin and reserves. This is not CEM's case as financial service institution.

Office supplies, passbooks and printed materials are accessories to its principal activity, which is collecting savings. Furthermore the amount of the estimated stock is 180,968,755, or 0.2% of

July 12, 2001

total assets. This amount does not constitute a "material impact" (technical term from the audit) on financial statements. (By issuing this exception in its opinion, Delta violated a generally accepted accounting principle, that of relative importance ("materiality principle").

Since this exception was noted, CEM's general administration has set up a management system for office supplies. Incoming and outgoing stocks are managed through a computer program. However a physical inventory check for 1999 was not carried out.

Third Exception: CEM's fiscal situation with regard to tax on profits.

In contrast to the two previous restrictions, the restriction regarding tax on profits is pertinent, referring to article 01.01.02 of the general tax code: CEM, as an EPIC, as a constituted body with financial autonomy, should pay tax on profits (IBS).

CEM should clarify its fiscal situation by obtaining an expert opinion from a fiscal advisor.

If this expert believes that CEM is exempt from IBS, CEM should submit this opinion to Delta in an effort to remove the restriction (with help from the fiscal expert if necessary).

If the fiscal expert believes that CEM should pay IBS: with the help of the fiscal expert, CEM should calculate the amount of IBS due, constitute a provision and initiate negotiations with the tax service regarding the final amount. These actions should satisfy the auditors and the restriction would not longer be needed, even before the taxes are paid.

Note: Revenues from interest from the treasury, which should be exempt from VAT, should be distinguished from revenues from Western Union, which may be subject to this tax.

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May 8 – July 31, 2000

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July 12, 2001

ATTACHMENT 5

FINAL DRAFT FOR DISCUSSION PURPOSES

CAISSE D'EPARGNE DE MADAGASCAR

PERFORMANCE YARDSTICKS

For

PROFITABILITY / SUSTAINABILITY

Contract no. PC-I-00-99-00007-00

Prepared for:

United States Agency for International Development
Antananarivo, Madagascar

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July 17, 2000

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1. INTRODUCTION

As part of the RFP for work on the Caisse d'Epargne de Madagascar, USAID requested assistance with "institutionalizing improved financial management measurements for long-term profitability." Accordingly, the Work Plan submitted by Chemonics and approved by USAID, included as a task, a review of current profitability / sustainability indicators for possible change, and the possible addition of one additional measurement. This white paper is in the result of work under this task, as well as USAID's special request for a submission of a separate report for its internal use.

In the RFP for the CEM the following result was set forth in Section B:

B. *"Assist the CEM in institutionalizing improved financial management methods for long term profitability. This would include reviewing the realism of established indicator targets for growth in clients and deposits, and assisting USAID and CEM in selecting an appropriate profitability/sustainability indicator to track the CEM's financial performance.*

* *Result: Profitability analysis is institutionalized within the CEM and profitability baseline and target figures are set and tracked. Examples:*

* *Return on Assets, i.e. (Net income after tax x 100)/Average Total Assets is greater than 1% per year.*

* *Return on Equity Capital (%), i.e. Net Income After Taxes x 100/Average Equity Capital is greater than 15%.*

* *Indicator: Periodic reporting on a selected profitability indicator to the board of governors is begun."*

The Work Plan approved by USAID specified the following task to be completed by July 28:

"Review CEM performance yardsticks for change and develop one additional one for AID to track profitability / sustainability."

In the course of completing this task, a 1999 assessment report by Chemonics International, as well as financial statements for the CEM for 1996 – 1998 (latest available), were reviewed. The U.S. Office of Thrift Supervision in Washington and San Francisco was contacted and research performed about prudential standards for thrift institutions. It was considered by the Chemonics team, that measurements considered and proposed should be both consistent with U.S. thrift industry standards and adapted to the especial character of the CEM and the nature of its operations.

The CEM is unique in Madagascar. With 517,000 depositors (as of March 2000) consisting mostly of small savers, it has by far the most extensive deposit base in the country and is the largest source of long-term liquidity in local currency. While credit activities are possible in the

future, substantially all of its deposits (85% as of December 1998) are now invested in Treasury bills and notes issued in Madagascar. With the exception of a dollar account used for transfers under its arrangement with Western Union, all of the CEM's operations are conducted in local currency (Malagasy francs). In the future as the CEM is privatized and obtains a banking license, credit activities will become possible.

The CEM management has no control over the bank's level of income, as 99.5% of its revenues (1998 figures) consist of interest on Malagasy treasury paper, the rates for which are set by the Ministry of Finance (beyond the control of management). CEM can (and does) set the rates payable on time deposits, which it can adjust as a function of treasury rates to assure "spread" income to cover operating costs. In other words, while CEM management cannot control the amount of income the bank is paid, it can and does assure profitability by altering cost of funds, which it does control.

2. CURRENTLY PROPOSED MEASUREMENTS CONSIDERED

Current profitability measurements (percentage return on assets and return on equity) are standard yardsticks for financial institutions worldwide, and the yardsticks indicated in the RFP (1% return on assets and 15% return on equity) are standard for commercial lenders. However, in the CEM's case today, it is not yet a commercial lender, and income is almost entirely a function of treasury bill rates set by the Treasury, over which CEM management has no control; moreover, by simply resetting rates paid on its own deposits and adjusting its financial spread income, CEM management can assure sufficient income to cover normal operating costs and assure some level of profit (see Section 1 above). While the future will likely bring change, the Chemonics team believes that any ratio or performance yardstick for the *current* CEM that is based upon income is out of context for the reasons above. *It is sufficient that the CEM generate some amount of profit regularly and that it also maintain adequate capital as a function of its assets (capital adequacy), for the purpose of judging its sustainability. On the other hand, the fact that profit may be generated cannot realistically be considered indicative of management's or CEM's "performance", except insofar as additions to equity capital accounts should be made from retained earnings to comply with prudential norms for capital adequacy (see Section 3 below). Accordingly, with respect to an income tax effect on profitability / sustainability, whether CEM is taxed as an "EPIC" or an "SA," is not relevant, provided that regular after-tax profits of some sort are generated and adequate capital is maintained. As an S.A. with commercial activities in the future, CEM would pay taxes and returns would be calculated after taxes in any event.*

Management's performance should be more appropriately measured by the efficiency of CEM's operations, which it can affect, in particular operating expenses as a function of deposits. In other words, a good performance test for the CEM would be the cost of conducting savings activities, rather than revenue from the re-investment of deposit resources garnered from those activities.

In the future, revenue-based measurements would be appropriate for the CEM as it attracts private investment and adds loan assets to its balance sheet (see Section 3.2 below for recommendations). Also, it should be mentioned, to avoid confusion, that its ability to attract private investment will not only be affected by projected returns from future operations as presented to prospective investors: Actual valuation for the CEM would be a function of a combination of factors, to include a premium for the intangible value of its deposit base overall.

3. TWO SCENARIOS RECOMMENDED FOR CONSIDERATION

In view of the potential privatization of the CEM and the possible inauguration of commercial (credit) activities in the medium term, two scenarios are depicted below with differences in performance yardsticks related to each:

- **Scenario 1:** The first scenario assumes the CEM as it is today --- an EPIC with earning assets invested in Treasury paper. This scenario could also be applied to the CEM as an SA if there are no commercial loans.
- **Scenario 2:** The second scenario assumes the CEM as more of a commercial lending institution, an SA partially privatized, with the bulk of its assets invested in Treasury obligations, but also a minority (10%) of its assets invested in commercial loans (micro-credit or other).

3.1 SCENARIO 1

Following are suggested performance yardsticks or tests for the CEM under Scenario 1:

1. **Some level of profit for two of the past three years.**
2. **Minimum "core capital" at 4% of assets in accordance with international norms for capital adequacy (See Attachment 1 from the U.S. Office of Thrift Supervision which sets forth the standard method of calculating risk-based capital).**
3. **Favorable trends in operating efficiency measured as a function of annual non-interest expenses divided by the average of year-to-year deposits.**

As of the latest figures available, CEM's operations may be considered to meet these standards: It has been profitable for the past three years; capital exceeds 4% of assets; and non-interest expense as a function of deposits is declining.

3.2 SCENARIO 2

Following are suggested performance yardsticks or tests for the CEM under Scenario 2.

1. **Some level of profit overall for two of the past three years.**
2. **Incremental profit of some amount from commercial credit activities.**

3. **Minimum risk-based capital at 4.4% of assets (core capital of 4% plus risk-based capital of 8% divided by risk assets (or commercial loans) assumed to equal 10% of assets).**
4. **Operating efficiency as measured in Scenario 1 above.**

To keep matters clear and also appropriately to reflect notions of opportunity cost (as the CEM as an economic matter can always choose to purchase Treasury bills as an alternative to loans), we recommend that operating costs allocable to new commercial loan activities for #2 above, be assumed to *equal the Treasury bill rate for comparable maturities. The Treasury bill rate would be assumed to equal CEM's all-in cost of doing commercial loan business.* In other words, if gross interest income from commercial loan activities *minus* a reserve for loan losses *minus* the comparable Treasury bill rate, yields a positive number, then test #2 will have been met. Fee income from commercial activities like letters of credit, etc., could be factored and added partially by formula.

The minimum capital figure used is a bare minimum. Higher percentages indicate a stronger and more sustainable institution (see Attachment 1).

As the CEM engages in commercial loan and credit activities both tests #2 and #3 above will be critically affected by the adequacy of loan loss reserves. If reserves are not high enough, incremental profit in #2 above will not be accurate, nor would levels of capital adequacy in #3. Decisions about these matters entail some level of subjectivity.

In the more distant future, if the CEM's Treasury operations become relatively less important compared with commercial credit activities, the performance yardsticks above should be reviewed again, with more standard revenue-based measurements applied in line with commercial norms and the measurements above in the RFP.

COMMENT

About

SELECTED RECOMMENDATIONS OF THE CEM DIAGNOSTIC REPORT
From Chemonics International

(Appendix 1 to RFP of March 2000)

("Assessment of the Caisse d'Epargne de Madagascar", September 1, 1999)

Point

A. Institutional Arrangements

A2. Status of Legislative Enactments

p. III-4 *"It is the opinion of the consultants that none of the recommendations in this report can or should be implemented, nor should the period of transition begin until all outstanding differences between the CEM and the government are resolved and all ambiguities in Law 95/019 are clarified."*

Comment

As of July 2000 the differences have been resolved and a new law is expected to be submitted to Parliament in September that will clarify CEM's legal status.

Point

B. Management

B1. Governance

III-5. *"Strongly advise that steps be taken as quickly as possible to establish a well balanced, well functioning Board of Directors (Conseil d'Administration) in keeping with the CEM's day to day management."*

Comment

CEM is currently an EPIC. As such, although a governing board does nominally exist, the shareholder's interests (the interest of the state) are represented by the General Secretary of the Ministry of Finance, who is President of the Conseil, as would be normal. Once the CEM is transformed into société anonyme or SA, a board of directors will be elected by the shareholders and may then be empowered by the by-laws to act as

such. As it is realistic that such a Board would be in place only after the new law is passed, the Chemonics team is concentrating the drafting and passage of the new legal framework.

Point

C. Operations
C5 Recommendations (Operations)

III-11 *“CEM should...set priorities, formulate an action plan, and secure the approval of the Board of Governors (Conseil d'Administration) to proceed with upgrading its operations.”*

Comment

Operations are in the process of being upgraded by management with support at the Board level (by the PCA) (see Attachment 3 to the Progress Report).

Point

D Management Information Systems
D6 Summary of Recommendation for MIS (in order of priority)

“Involve the Board of Directors and senior management in policy formulation and decision-making on MIS operations as appropriate, and, on this basis, formulate or introduce information technology operating procedures that reflect policies that have been agreed to.”

“Ensure that all changes to systems hardware, software and data are properly authorized, tested and implemented; the system is appropriately documented; and changes introduced are recorded.”

Comment

The CEM needs an integrated systems software package suitable to thrift institutions in a Francophone operating environment. This would address concerns about MIS, systems procedures and controls, testing and documentation, and “auditability.” The team is addressing this need and has identified it as a critical factor for the success of the CEM (See Section 5 of the Progress Report). Having stated this, it is also the team’s opinion that the internal situation at the CEM generally in the area of operational control and flow of information, is better than expected and that corrective actions have been taken and that controls have been put in place in many instances (see Attachment 3 of this report).

SECTION IV CONCLUSIONS AND RECOMMENDATIONS

Point

IV-2:

1. "All ambiguities and outstanding problems relating to Law 95/019 be resolved.
2. The government commits to the phased sale of a portion of its shares until its ownership is reduced to that of a minority shareholder."

Comment

CEM's legal status will be clarified in the short term partly as a result of technical assistance provided by the Chemonics team.

A significant first step can be taken with transformation CEM's legal status, the sale of a minority interest to private investors, approval by CSBF of a license, the commencement of some level of credit activity, and further progress in institutional development and capacity building to position CEM for full privatization at some point in the future. However, in view of the continuing development mission advocated by GoM and USAID in providing services to small savers that would not otherwise be available through private commercial financial institutions, we no longer advocate that the GoM commit to a timetable for the phased sale of its shares. We believe that majority private ownership and resultant maximization of shareholder returns would conflict with CEM's current development mission and the interests of CEM stakeholders. Timing of future steps in the privatization process will therefore depend upon the evolution of the CEM, its future status, and the interests of its stakeholders.

ATTACHMENT 7

TERMS OF REFERENCE FOR THE AUDIT

***Of the Caisse d'Epargne de Madagascar (CEM)
For financial year January 1, 1999 to December 31, 1999***

1 - Basic considerations for the audit

The terms of reference supply basic information that the auditor would need to be able to understand the assignment, prepare a proposal, and plan and carry out the audit. Nevertheless, this information should be considered in conjunction with the following publication: *International Auditing Standards*, published by the International Federation of Accountants (IFAC). Indeed, this publication forms an integral part of these terms of reference.

2 - Relations and Responsibilities

The client of this audit is the Caisse d'Epargne de Madagascar (CEM), and USAID/Madagascar is an interested party. A USAID representative may participate in start-up and close-out meetings regarding the audit, supervise work carried out by the auditors to ensure that they respect the terms of reference and applicable auditing standards, and issue comments on the draft audit report.

CEM is responsible for drawing up all financial statements and reports necessary and to ensure that all necessary documents are placed at the disposal of the audit, that all accounting entries and adjustments are done and that all necessary steps are taken to permit the auditors to submit the final report on the expected date.

Auditors should properly file and store all work documents for a period of three years after the end of the audit. During this time, the auditors should promptly supply work documents requested by CEM or USAID.

3 - Context

CEM possesses the largest network of savings services in Madagascar. It is composed of nine agencies located in Antananarivo (2), Antsirabe, Tamatave, Fianarantsoa, Nosy be, Mahajanga, Diego and Tulear. It also mobilizes savings accounts via 162 savings counters of the Post Office. CEM's clients include households, artisans, traders, farmers, small enterprises, local administrations, religious groups and educational establishments.

CEM offers competitive interest rates and immediate availability of funds. The principal and most popular product is the savings passbook, which requires a very low minimum balance (100 fmg) and that allows unlimited transactions (deposits and withdrawals). This product attracts

low-income clients, young people, and new savers. CEM also offers savings accounts that require larger deposits with higher interest rates; this product attracts larger savers and small enterprises. CEM manages more than 500,000 savings passbooks, or 7% of Madagascar's adult population. As of May 2000, the amount of deposits is 140 billion fmg.

CEM has undergone several changes since its creation in 1917 by the French administration as an agency of the Madagascar Post Office (Paositra Malagasy). CEM became the property of the Malagasy state in 1975. In 1985, with decree 85-601, it was converted to a public establishment of the industrial and commercial type, or EPIC.

Law 95-019 changed the institution to a corporation (societe anonyme, SA). The decree of application of this law has never been promulgated and the legal status of CEM has been ambiguous since this date. In May 2000, a team from the firm Chemonics worked to clarify the status of the institution and came to the conclusion that it remains an EPIC until the status changes.

The purpose of the assignment of the Chemonics team, financed by USAID, is to help CEM become a private corporation. Along these lines, Chemonics reviewed and corrected law 95-019 in order to give CEM an evolutive legal structure allowing the Malagasy government to gradually reduce its participation in the institution and allowing CEM to become a private autonomous financial institution. As a first step, minority participation by the private sector is envisaged. The present audit report constitutes an essential document in the ongoing process of disengagement of the Malagasy government.

The purpose of the Madagascar USAID mission is to Reduce Poverty. The micro-enterprise activity of the Mission has been supporting CEM since 1993, since this is the national financial institution of Madagascar that offers savings accounts to low-income households. USAID has supplied technical assistance, training, and equipment to improve CEM's financial management as well as drawing up directives and putting them in place, in an effort to ensure financial sustainability, operational efficiency, better services to clients, update information management systems, and to guide its transition to an independent financial services institution.

CEM's accounts are certified each year by the offices of Martin Rasoanaivo; the certified fiscal year 1999 is available. An audit according to IFAC standards was commissioned by USAID for fiscal year 1997 and carried out by the firm Delta Deloitte & Touche.

4 - Objectives of the audit

Financial audits and internal controls should adhere to international auditing standards published by IFAC (International Federation of Accountants) and should include verification of accounting documents that the auditors deem necessary to do so. The specific purposes of the audit are as follows:

- State an opinion indicating if, everything pertinent considered, CEM's financial statements reflect a faithful image of CEM's financial situation, as well as results of its operations and treasury movements as of December 31, 1999, in conformity with generally accepted accounting principles.
- State an opinion indicating if the systems of internal controls of CEM are satisfactory.
- State an opinion indicating if CEM respects all relevant laws and regulations, as well as its contractual obligations.

5 - Scope of the audit

The audit should include appropriate planning, evaluation and verification of the structure and mechanisms of internal controls and obtain sufficient objective information to permit the auditors to arrive at reasonable conclusions which will serve as the basis for their opinions. As they work, they should pay special attention to the following requirements:

- That the assets of the savers reflects the amount effectively due by CEM to depositors as of December 31, 1999. If there are delays in transmitting documents of withdrawal or deposit or summary statements by the Post Office Administration, a better estimate is made by CEM for the undocumented amount to obtain a faithful reflection of the assets of savers as of December 31, 1999.
- That interest charges are actually calculated on the credit balances of savers from January 1 through December 31, 1999, including on the amount estimated discussed in the preceding paragraph.
- That revenues from funds placed in the Public Treasury include amounts that the latter commonly grants, that is to say, on the dates of value of the funds that the Post Office Administration has not yet transferred.

Auditors should respect established auditing standards, and as a result should include tests of accounting entries that they consider necessary in the circumstances.

6 - Other responsibilities of the auditor

- A. Hold start-up and close-out meetings with CEM
- B. Submit a draft report to CEM two weeks prior to the close-out meeting
- C. Establish independently references of the audit report before its submission
- D. Obtain a letter of declaration in conformity with international auditing standards, signed by CEM management

7 - Audit Reports

Once the audit is finished, the auditors issue their opinion regarding CEM's financial statements. All reports emanating from the audit should be included in a single document. The auditor should submit the final audit report to CEM on the date due. The reports are submitted, duly

signed and bound, in one original and 15 copies, as well as an English translation of the summary letter. The report regarding the CEM audit should include at least:

- A. A title page, table of contents, cover letter, and another letter summarizing the context, the purposes of the assignment and the findings of the work.
- B. The audit report and the opinion regarding CEM's financial statements, notes, and relevant supplementary information.
- C. The audit report and the opinion on the structure of internal controls at the CEM. The report should include situations to be pointed out (those with an impact on financial statements), including precise indication of serious shortcomings in CEM's structure of internal controls, as well as comments on it.

This report should include a section regarding following through with recommendations from previous audits, most especially the Delta Deloitte & Touche audit report from fiscal year 1997, indicating the current status of situations which had previously been the subject of recommendations, whether they have been corrected, partially corrected, or not corrected. Shortcomings that have not yet been corrected should be pointed out again in the current audit report, along with comments from CEM.

- D. The audit report and the auditor's opinion regarding CEM's respect of relevant laws and regulations, as well as CEM's adherence to its contractual obligations.
- E. A summary of the principal auditing procedures followed in preparing the audit, evaluating the structure of internal controls, verification of figures on financial statements and other reports submitted for the audit, and an evaluation of CEM's adherence to relevant legal and regulatory provisions

8 - Examination and acceptance of the work and audit reports

CEM is responsible for examining and accepting the audit report and may assign corresponding duties to a person or an enterprise, including the examination of working documents and quality controls relevant thereto. If CEM does not accept one or more audit reports due to deficiencies in the audit work, the auditor will proceed with additional work necessary without additional charge to CEM.

9 - Deadline and Payment

The auditor will submit the preliminary report on or before _____ and the final report on or before _____.

Payment for audit services will be as follows: 20% on the start date of services of the audit company, 50% upon submission of the preliminary report and 30% upon acceptance of the final report by CEM.

10 - Level of effort

The auditing company is requested to supply the following man/days:

Associate	2 days
Manager	10 days
Senior	15 days
Junior	15 days

11 - Selection Criteria

Cost		30%
Technical criteria		70%
Experience of the firm	30%	
Experience and qualification of proposed personnel	30%	
Experience of the firm and proposed personnel in savings banks	20%	
Experience in Madagascar	10%	
Technical approach as described in the proposal	10%	

12 - List of firms contacted

PriceWaterhouse Coopers
Ernst & Young
Delta Deloitte & Touche
Arthur Andersen
KPMG

SUMMARY TRAINING PLAN

CAISSE D'EPARGNE DE MADAGASCAR

OCTOBER 2000

Background

As part of its work pursuant to the work plan for the Caisse d'Epargne de Madagascar, members of the Chemonics team plan to present three seminars in from October 20 - 31 to personnel of the CEM. The seminars will vary in length between two and three days. The topics have been discussed at length with CEM management, who is appreciative and very interested in the value of this part of our work under the contract. A budget is in the process of being put together to support the seminars that will be paid by Chemonics as part of the current contract. Abraham Elison, team member, is responsible for administrative tasks related to the training sessions.

A summary of each seminar, the content, instructors, and participants, are set forth below.

Financial Management

Instructors: Khai Nguyen assisted by Warren Chase

Participants: Employees and managers of the CEM head office and branches (25 people)

Duration: 3 days

Content: Principles of internal control and organization, the audit function, principles of international accounting, performance yardsticks and how to measure, management of the savings function and its efficiency.

Corporate Governance

Instructors: Frederick Dulls assisted by Osman Shahenshah

July 12, 2001

Participants: Key senior managers of the CEM, officials from the Ministry of Finance and others as may be designated by the President of the CEM who are current or prospective board members (15 people).

Duration: 2 days

Content: Corporate governance in a private corporate environment. How to organize and staff a board meeting. Directors' responsibilities v. those of management. Cases from overseas involving director liability and action. It is contemplated that there would be a mock practice board meeting with a critique to follow as part of the seminar.

Credit Management

Instructors: Warren Chase assisted by Judith Beckwith

Participants: Key management of the CEM (15 people).

Duration: 2-3 days

Content: An introductory seminar in the principles of credit management and administration, to include: organization of a credit function, documentation, credit approval and review, the process of credit training and experience, forms of collateral. Types of micro-credit and small business credit in Madagascar will be shown and potential activities for the CEM discussed and their risks. Two actual cases or dossiers from Madagascar will be handled (one micro-finance and one PME), with lessons drawn from each.

July 12, 2001

Attachment 9

MEMORANDUM

TO: Warren Chase
FROM: Frederick Dulles
CC: Ken Smarzik, Osman Shahenshah
SUBJECT: Madagascar CEM – Privatization Process

Date: 22 July 2000

The privatization of Malagasy state enterprises is governed principally by Law n° 96-011 dated 13 August 1996, as amended, providing for the disengagement by the State of its interests in the public sector. This law has been modified by Law n° 98-014 of 19 November 1998 and implemented by Decree n° 96-782 dated 4 September 1996, as amended by Decree n° 96-1160 of 12 November 1996. In addition, Law n° 96-012 dated 13 August 1996 provides for settling disputes relating to privatizations through a special arbitration procedure. The process is directed by the Ministry of Privatization and administered by the Comité de Privatisation (CP or the "Committee") and its Secrétariat Technique (ST).

The Law and the Committee speak of mostly of disengagement rather than privatization because the program is aimed, not at privatizing the economy, but rather at getting the State out of economic activities that it prefers not to be in or where the burdens on the State are considered too great. This means that Committee may liquidate an enterprise if a suitable private investor cannot be found. For the Committee, privatization means that 67% or more of the shareholding is transferred to the private sector, reducing the State's interest to below the one-third (1/3) blocking minority level.

There have been two decrees that have listed a total of 47 state enterprises that are to be privatized. We have heard that another decree is expected sometime in the future listing a third wave of state enterprises that will comprise the third wave of privatization. We do not know whether the Caisse d'Epargne de Madagascar (CEM) will be on the list, but we learned from the ST that it does not have to be one the list for the State to carry out a partial reduction of its shareholding, such as the proposed reduction by 30%.

Disengagement Process

The disengagement or privatization process for an enterprise goes through four stages: review of the enterprise, development of a privatization plan, implementation of the plan and effective privatization.

The Committee carries out the process through independent external consultants called "organes techniques" (OT). These must be consulting firms, independent experts, financial institutions or banks that have experience in privatization. They are recruited through a tender or other competitive and transparent process. Normally, there is a first OT that prepares a study of the enterprise and develops a plan for the privatization. Then there is a second tender to select another OT, often an investment bank, to carry out the plan and complete the privatization. However, the OT for the first two stages may be selected as OT for the third and fourth stages.

In the case of the CEM, where USAID and our Chemonics team will have done the work of an OT for the first two stages of privatization, the ST indicated that the Committee would most probably use our work product rather than engaging another OT. The ST indicated that the fact that Chemonics was hired by a USAID through a tender process would satisfy the Malagasy requirement for a tender for the OT.

Law 96-011 provides for the establishment of *société anonymes* to become the vehicle for privatizing a state enterprise, even with the State as sole shareholder during a transition period (of unspecified duration).

The law provides that disengagement or privatization may be carried out through an open tender, a restricted tender after an open pre-qualification process, an auction, a public sale of shares, or a sale on the financial markets, particularly on a stock exchange.

The transaction may take the form of a sale of shares, an exchange of shares, a waiver of the State's pre-emption rights to subscribe to increases in capital or a transfer of such rights, any form of capital increase, merger or spin-off, issuance of any form of financial instrument, transfer of assets, dissolution or liquidation of enterprises, management or lease contracts coupled with an undertaking to purchase the enterprise, concessions or similar arrangement.

Strategic investors will be obligated to retain their shares for at least two years.

In the case of a transfer of shares to individuals, there is an exemption from all taxes on capital gains for five years after subscription.

Stages One and Two

The OT for the first two stages has to prepare a plan of privatization, a valuation of the enterprise, the detailed procedure for the privatization, the tender documents. The OT can propose a privatization in stages.

The CP has the right to require production of any documents concerning the enterprise in question that might be useful for the privatization.

Stages Three and Four

July 12, 2001

The OT prepares the "Cahier des Charges" which set out the specific procedures for carrying out the privatization and any conditions or requirements placed on potential investors. The OT will prepare the Information Memorandum for the tender. The OT organizes a data room where all of the relevant documents related to the enterprise are brought together. Typically, potential investors are expected to put up a significant fee to get a copy of the Cahier des Charges and to get access to the data room. The OT may organize a road show to spread information about the enterprise.

In a restricted tender, the OT prepares the objective criteria for the open pre-qualification of potential investors, including the choice of strategic investors, potential for improving the performance of the enterprise, the level of the financial offer and the impact of the offer on the local and national economy.

The OT reviews bids submitted and carries out the procedures required to complete all of the formalities of privatization.

Other matters

Creditors of an enterprise that is on the list set forth by decree of state enterprises being privatized have four months following publication of that decree in the *Official Journal* to declare their claims to the CP.

The Law has also created a "Fonds de Portage et de Privatization" which provides a means for employees and small investors to acquire shares in privatized enterprises. The Fund may take over up to 20% of the State's shares in a privatized enterprise – i.e., out of the 33% that the State may retain – which it retransfers to these small investors with certain discounts and extensions of credit.

The Law also created a "Fonds Social et d'Appui pour le Développement Régional" which has the purpose of providing assistance and subsidized microfinance credit to persons who may be affected by privatizations to enable create micro-enterprises.

For the initial 30% disengagement from the CEM that we are working on, these Funds will probably not be a consideration.

A. H. D.