OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/KENYA'S COMPLIANCE WITH FINANCIAL AUDIT REQUIREMENTS REGARDING FOREIGN RECIPIENTS

AUDIT REPORT NO. 4-615-06-011-P

July 31, 2006

PRETORIA, SOUTH AFRICA

Office of Inspector General

July 31, 2006

MEMORANDUM

TO: USAID/Kenya Mission Director, Stephen Haykin

FROM: Acting Regional Inspector General/Pretoria, Matthew Rathgeber /s/

SUBJECT: Audit of USAID/Kenya's Compliance with Financial Audit Requirements Regarding Foreign Recipients (Report No. 4-615-06-011-P)

This memorandum transmits our report on the subject audit. In finalizing this report, we considered management comments on the draft report and have included those comments, in their entirety, as Appendix II.

The report has seven recommendations to help USAID/Kenya improve its financial audit program with regard to foreign recipients. In response to the draft report, the Mission provided corrective action plans for Recommendation Nos. 1, 4 and 6. For Recommendation No. 3, USAID/Kenya has amended its Mission Order regarding Audit Management, dated May 31, 2006. For Recommendation No. 7, the Mission agreed to submit all host country contract audits to RIG/Pretoria. Management decision has been reached for Recommendation Nos. 1, 3, 4, 6 and 7. Please provide the Office of Audit, Performance, and Compliance Division with the necessary documentation to achieve final action on the recommendations.

Recommendation Nos. 2 and 5 remain open without management decision until the Mission provides a target date for completion of action and the Mission obtains and submits audit reports identified in Appendices III and IV to RIG/Pretoria.

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

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SUMMARY OF RESULTS

The Regional Inspector General/Pretoria performed this audit to determine whether USAID/Kenya effectively managed its financial audit program in accordance with USAID policies and procedures for fiscal years 2003, 2004, and 2005. (See page 2.)

USAID/Kenya did not effectively manage its financial audit program during the period covered by the audit. Specifically, USAID/Kenya did not ensure that planned audits of recipients were performed in a timely manner, delinquent audits were followed up on and completed, or standard statements of work were used. To help correct and strengthen these problem areas, we recommended that USAID/Kenya 1) develop and implement an audit tracking system to better monitor and ensure timely submission of planned audits, 2) complete all identified delinquent audits, and 3) develop a system to ensure that standard statements of work are included in future audit agreements. (See pages 4 - 7.)

In addition, although USAID/Kenya prepared award inventories and annual audit plans for fiscal years 2003-2005, the inventories and plans were incomplete. Specifically, the plans omitted required closeout audits for 16 expired awards. The amount of USAID funding included in those awards totaled $15.3 million. We recommended that USAID/Kenya 1) amend its Mission Order dealing with recipient audits to ensure that expiring awards requiring closeout audits are included in future audit plans, 2) complete all required closeout audits, 3) amend Mission procedures regarding audits of host country contracts, and 4) have required closeout audits performed for two expired host country contracts. (See pages 7 - 10.)

In response to the seven recommendations in the final report, the Mission provided corrective action plans for Recommendation Nos. 1, 4 and 6. For Recommendation No. 3, USAID/Kenya has amended its Mission Order regarding Audit Management, dated May 31, 2006. For Recommendation No. 7, the Mission agreed to submit all host country contract audits to RIG/Pretoria. Management decision has been reached for Recommendation Nos. 1, 3, 4, 6 and 7. Recommendation Nos. 2 and 5 remain open without management decision until the Mission provides a target date for completion of action and the Mission obtains and submits audit reports identified in Appendices III and IV to RIG/Pretoria. (See page 11.)

BACKGROUND

USAID administers most of its foreign assistance programs by awarding contracts, grants and cooperative agreements to U.S.-based and foreign organizations. In order to help ensure accountability over funds given to such organizations, USAID and the Office of Inspector General (OIG) have jointly developed a financial audit program as outlined in Automated Directives System (ADS) 591. This section of the ADS requires that USAID missions, in consultation with the cognizant Regional Inspector General (RIG), ensure that required financial audits are conducted for foreign for-profit and nonprofit organizations and host government entities (including any Mission-funded activities in nonpresence countries), and local currency special accounts.

All foreign nonprofit organizations expending more than $300,000 of USAID funds during their fiscal year are required to have an annual financial audit performed. A closeout audit is required for recipients expending more than $500,000 throughout the life of an award. Incurred cost audits must be performed annually of all foreign for-profit organizations performing under direct awards or cost reimbursable host country contracts and subcontracts.[1] To ensure that such audits are performed in a timely and acceptable manner, Missions are required to develop annual audit plans which are populated from inventories maintained by the Missions of all contracts, grants and cooperative agreements, including cash transfer and nonproject assistance grants, awards financed with host country owned local currency and activities in nonpresence countries for use in determining audit requirements.

The audits are normally performed by independent auditors acceptable to the cognizant RIG office and contracted by recipients using a standard statement of work. On occasion, USAID missions may contract directly with an audit firm to conduct financial audits of foreign recipients or locally-incurred costs of U.S.-based recipients. Audits of USAID recipients are required to be performed in accordance with U.S. Government Auditing Standards as well as the OIG's *Guidelines for Financial Audits Contracted by Foreign Recipients*. Missions must ensure that such audit reports are submitted to the cognizant RIG for review and issuance no later than nine months following the end of the audited period.

USAID/Kenya is one of the USAID missions in the Eastern and Southern Africa region with a large number of recipients. In fiscal year 2005, the Mission had 55 non-U.S.-based recipients. During fiscal years 2003-2005, USAID/Kenya reported budget authorizations totaling $243.2 million for programs in:

- HIV/AIDS, Population, and Health.
- Natural Resources Management.
- Democracy and Governance.
- Increased Rural Household Incomes.
- Basic Education.

[1] In terms of a 2005 revision to ADS 591, there is no automatic requirement for annual incurred cost audits for foreign for-profit organizations. Instead, Missions are required to annually assess risks to determine whether financial audits are warranted and the results of these risk assessments must be shared with the cognizant RIG office.

AUDIT OBJECTIVES

The Regional Inspector General/Pretoria (RIG/Pretoria) performed this audit of the Mission's compliance with financial audit requirements regarding foreign recipients because RIG/Pretoria's experience is that USAID missions in eastern and southern Africa have generally not been complying with Automated Directives System (ADS) 591 in terms of ensuring that required financial audits of foreign recipients are conducted in a timely and acceptable manner. To determine USAID/Kenya's compliance with USAID rules and regulations regarding financial audits of its foreign recipients, the audit was performed to answer the following questions:

Objective No. 1: Did USAID/Kenya ensure that planned financial audits of foreign recipients were performed and submitted in accordance with USAID rules and regulations?

Objective No. 2: Did USAID/Kenya ensure that annual audit plans included all recipients from their award inventory that required a financial audit?

Refer to Appendix I for detail of the audit scope and methodology.

AUDIT FINDINGS

Did USAID/Kenya ensure that planned financial audits of foreign recipients were performed and submitted in accordance with USAID rules and regulations?

USAID/Kenya did not ensure that all planned financial audits of foreign recipients[2] were performed and submitted in accordance with USAID rules and regulations.

During the last three years, USAID/Kenya has made a great deal of progress towards improving its recipient financial audit program. USAID/Kenya has planned for and submitted its audit inventories and audit plans to RIG/Pretoria for fiscal years 2003 - 2005. Since October 1, 2003, RIG/Pretoria has issued four financial audit reports of USAID/Kenya recipients covering $2.7 million in expenditures of USAID funds. Those audit reports included recommendations that addressed $1.2 million in questioned costs, 16 internal control weaknesses, and 8 instances of material noncompliance with applicable laws and regulations.

There were several areas identified during our audit in which USAID/Kenya could improve its recipient financial audit program including timeliness, follow-up on delinquent audits, and use of a standard statement of work.

Audit Reports Not Submitted Within Required Timeframe

Summary: According to Agency policy, USAID missions must submit audit reports of foreign recipients to the cognizant Regional Inspector General (RIG) no later than nine months after the end of the audited period. Only 4 of 21 audits in USAID/Kenya's audit plans for fiscal years 2003 to 2005 were submitted to RIG/Pretoria within the required timeframe. This occurred because USAID/Kenya had not developed an effective system to track and follow up on planned audits. Audits that are not completed in a timely manner reduce USAID's accountability over funds awarded to recipients.

Automated Directives System (ADS) 591.3.2.1 requires that foreign nonprofit organizations and host governments that expend $300,000 or more of USAID funds during their fiscal year must have an annual audit conducted in accordance with the Office of Inspector General's *Guidelines for Financial Audits Contracted by Foreign Recipients* (Guidelines). Paragraphs 1.16 and 2.3 of the Guidelines spell out the timeframe within which recipients must submit final audit reports to the cognizant USAID mission, which, in turn, will forward them to the RIG for review and issuance. According to the Guidelines, the cognizant RIG must receive the audit report no later than nine months after the end of the audited period.

[2] For the purpose of this audit, foreign recipients include non-U.S.-based grantees and contractors who were awarded grants, contracts or cooperative agreements.

USAID/Kenya's annual audit plans prepared for fiscal years 2003, 2004, and 2005 included 21 distinct planned financial audits of 13 different recipients. The breakdown of the 21 audits is presented in Table 1 below.

Table 1
Recipient Audits in Annual Plans for Fiscal Years 2003-2005

Number of recipients	# of annual audits in plans	Totals
3	3	9
2	2	4
8	1	8
13		21

Of the 21 planned audits, only 4 (19%) were submitted to RIG/Pretoria for review and issuance on or before the required due date. On average, audit reports were submitted 140 days (approximately five months) after they were due.

The lack of timeliness was caused by several factors. One of the principal factors was that the Mission's tracking system to ensure that the planned audits were performed and submitted within the required timeframe needed enhancement to be effective. As a result, not only were the planned audits not submitted in a timely manner, but many were not submitted at all. For example, only 8 of the 21 audits included in the Mission's audit plans for fiscal years 2003, 2004, and 2005 had been submitted to RIG/Pretoria as of December 31, 2005. The remaining 13 audits (listed in Appendix III) had either not been performed, or, if performed, had not been submitted to RIG/Pretoria.

Delayed performance and submission of audit reports reduces USAID's accountability over funds awarded to recipients. This also increases the risk that recipients' financial records are no longer available for audit, or that their offices have ceased operations making the determination and recovery of potential questioned costs difficult or impossible. Even when records do exist, or the recipient is still in operation, untimely audit reports lose their usefulness because management (USAID or recipient) cannot, based on the reports, implement corrective actions in a timely manner to prevent potential fraud, waste and abuse. Total estimated expenditures not audited on a timely basis amounted to over $11.5 million, while the estimated expenditures of planned audits not submitted at all amounted to over $9.4 million.

For the mission to be able to submit timely audit reports to RIG/Pretoria, it must have an effective system to monitor the status of planned audits and dedicated personnel to provide interventions when targeted milestones are not being met. Therefore, we are making the following recommendations:

Recommendation No. 1: We recommend that USAID/Kenya develop and implement an audit tracking system to monitor the recipient financial audit process to ensure timely submission of reports to RIG/Pretoria. This system should, at a minimum, include controls to document that:

- *Appropriate timing targets and milestones are set for each audit in the Mission's current audit plan.*

- *Audit instructions are sent to recipients prior to the recipient's fiscal year end requesting them to initiate the procurement for the audit.*
- *Periodic follow-up is performed to determine the implementation status of all planned audits.*
- *Corrective actions are taken and documented for audits that are not progressing as planned.*

Recommendation No. 2: We recommend that USAID/Kenya obtain and submit audit reports for all recipients with delinquent audits.

Standard Statement of Work Not Used in Every Audit

Summary: Agency policy requires that audit agreements between recipients and independent auditors contain a standard statement of work (SOW) that incorporates all the requirements of the OIG Guidelines. Not all of the financial audits of USAID/Kenya's recipients contained a standard SOW that was reviewed and approved by the Mission. This occurred because USAID/Kenya did not have a system to ensure that all audit agreements incorporated standard SOWs. The lack of a standard SOW has resulted in many audits being rejected by RIG/Pretoria due to lack of compliance with applicable auditing standards and guidelines.

According to the OIG's *Guidelines for Financial Audits Contracted by Foreign Recipients* (Guidelines), a mandatory reference in ADS 591, USAID missions must ensure that audit agreements between USAID recipients and independent auditors include a standard statement of work (SOW) containing all of the requirements of the *Guidelines*. To ensure that this requirement is complied with, recipients must send all prospective audit agreements to the cognizant USAID mission for approval prior to finalization, as stated in paragraph 1.14 of the *Guidelines*.

Experience has shown that independent audit firms conducting USAID recipient audits without a standard SOW typically perform "statutory" audit work in accordance with local standards. Such audits do not address the unique fieldwork and reporting requirements of USAID audits relating to such areas as testing expenditures for eligibility, allocability, and compliance with U.S. laws and regulations. Financial audit requirements for USAID recipients differ substantially from statutory audit requirements within Kenya. Consequently, audits that are conducted without a Mission-approved agreement containing the standard SOW, which refers to the audit requirements in the OIG Guidelines, are less likely to be performed in accordance with U.S. Government Auditing Standards and/or the OIG Guidelines. This was reflected in the large percentage of recipient audit reports that RIG/Pretoria rejected due to lack of conformity with those standards and guidelines. Of the eight reports submitted to RIG/Pretoria, four (50 percent) were initially rejected due to lack of compliance with applicable standards and guidelines.

We judgmentally selected six submitted audits to determine whether the Mission reviewed and approved the audit agreements between recipients and auditors. Of the six audits reviewed:

- The Mission did not review and approve the SOW prior to the commencement of five of the audits.
- The Mission did not ensure that the audit agreement between the recipient and the auditors contained a Mission-approved standard SOW for any of the six audits.

A number of recipient audits were not performed under agreements which included the standard SOW because USAID/Kenya did not have a system in place to ensure that all audit agreements were reviewed and approved by the Mission prior to the commencement of the audits. Therefore, the Mission could not ensure that the standard SOW was incorporated into those audit agreements.

The review and approval of prospective audit agreements, and the inclusion of a standard SOW in those agreements which references specific USAID audit requirements, will help prevent audits from being performed that do not comply with U.S. Government Auditing Standards and/or the OIG Guidelines. Once incorporated into the audit agreement, the standard SOW becomes binding and should compel the audit firms to comply with necessary USAID audit requirements. Therefore, we are making the following recommendation:

Recommendation No. 3: We recommend that USAID/Kenya develop and implement a system to verify and document that the Mission reviews, approves and maintains a copy of an audit agreement containing a standard statement of work that incorporates USAID's audit requirements for every recipient audit.

Did USAID/Kenya ensure that annual audit plans included all recipients from its award inventory that required a financial audit?

USAID/Kenya did not ensure that annual audit plans included all recipients from its award inventories that required a financial audit.

As required by ADS 591.3.4.2, USAID/Kenya developed award inventories for fiscal years 2003, 2004, and 2005 which included the required information for each award, including contractor/grantee name, type of organization, award number, amount in U.S. dollars, start/completion dates, prior audits and period covered, receipt date for required audits, dates for planned audits, and reason(s) for not including an award in the annual audit plan. The Mission also developed an annual audit plan for each of those fiscal years which included 21 distinct audits of foreign recipients receiving awards listed in those inventories.

Although USAID/Kenya prepared the award inventories and related audit plans as required, not all awards that required audits were included in the audit plans.

Awards Requiring Closeout Audits Need To Be Included In Audit Plans

Summary: Agency policy requires that all awards in excess of $500,000 be subject to a final closeout audit. The policy also states that annual incurred cost audits must be accepted as fulfilling closeout audit requirements. USAID/Kenya's annual audit plans omitted 16 expired direct awards that required closeout audits. This occurred because Mission officials were unaware that closeout audits were required. As a result, $15.3 million of USAID funds that should have been audited remains unaudited.

Automated Directives System (ADS) 591.3.3.2 states that Contract Information Bulletin (CIB) 90-12 requires "all awards in excess of $500,000 be subject to a final closeout audit." This section of the ADS also states that annual audits, performed in accordance with the *Guidelines for Financial Audits Contracted by Foreign Recipients* must be accepted as fulfilling the close-out audit requirements for foreign nonprofit organizations.

The intent of CIB 90-12 is to ensure that awards that do not exceed the $300,000 threshold for an annual audit, but expend significant amounts on a cumulative basis, are audited to ensure proper closeout of the award. The Mission's award inventories included columns with labels such as "Prior Audits & Dates Covered" and "Reason not in Audit Plan." The data from these columns provided information as to the most recent annual audit prior to the recipient's award completion date. The information from the Mission's award inventories was used to determine whether a close-out audit was required for a given recipient.

USAID/Kenya's award inventories for fiscal years 2003–2005 included 16 recipients with expired direct awards over the $500,000 threshold, which were not included in the Mission's respective annual audit plans. According to the Mission's award inventories for fiscal years 2003–2005, and audit plans for fiscal years 2003–2005, these expired awards had no recent annual audits prior to the recipient's award completion date. Consequently, required closeout audits were not conducted for those awards. A list of the 16 awards requiring closeout audits is included as Appendix IV in this report. The following table presents the aging of the unaudited expired awards as of December 31, 2005. As shown in the table, the majority of these awards expired more than two years ago.

Table 2
Aging of Expired Awards Requiring Closeout Audits

0-1 yr.	2-3 yrs.	4-5 yrs.	Total
4	9	3	16

Mission officials did not include these expired awards in annual audit plans because they were unaware of the policy regarding closeout audits. The reason stated in the Mission's award inventories for not including such awards in the annual audit plans was that the annual expenditures were less than $300,000. In addition, there was no recent audit performed prior to the award completion date. Also, USAID/Kenya's Mission Order dated May 1, 2002, which addresses recipient financial audits, did not include any procedures regarding the planning or performance of closeout audits of awards exceeding $500,000.

As a result, 16 expired direct awards that should have received closeout audits remain unaudited. The amount of USAID funding included in those awards totaled $15.3 million.

Closeout audits are important tools in the control and accountability of USAID funds. Such audits may be used, among other things, to finalize indirect cost rates and to determine whether the disposition of USAID-funded assets was properly performed at the end of a project or activity. A closeout audit of expenditures of USAID funds would be especially important when a recipient may have expended less than $300,000 in any single year, but the total award was over $500,000. Such recipients may never have been subject to a USAID audit as required. Further, according to ADS 591.3.3.2, Contract/Grant Officers cannot proceed with the closeout process until final action has been taken on all audit recommendations. Finally, because they were not included in the Mission's audit plans during the period they were due; such audits would not be performed within the required timeframe. We are, therefore, making the following recommendations:

> *Recommendation No. 4: We recommend that USAID/Kenya amend its Mission Order dated May 1, 2002 to document that closeout audits of expiring awards in excess of $500,000 are included in future audit plans and performed as required.*

> *Recommendation No. 5: We recommend that USAID/Kenya obtain and submit audit reports for all expired awards requiring closeout audits.*

Host Country Contracts Audit Procedures Need To Be Included in Mission Order

Summary: Agency policy requires missions to maintain an inventory of all awards from which annual audit plans may be developed. Agency policy also dictates that host country contracts[3] are subject to the same USAID audit requirements as direct contracts. Two host country contracts requiring financial audit did not receive timely audits. This occurred because host country contract audit procedures were not in USAID/Kenya's Mission Order. As a result, two contracting entities had to have financial audits covering several years that could affect the Mission's oversight of USAID funds.

ADS 591.3.4.2 requires missions to "maintain an inventory of all contracts, grants and cooperative agreements, including cash transfer and nonproject assistance grants, awards financed with host country-owned local currency, and activities in nonpresence countries for use in determining audit requirements." Country Contracting Handbook section 3.8 states that an audit of non-U.S.-based firms shall be a cost-incurred, financial audit performed by the principal audit agency to the host country or an independent audit agency acceptable to the USAID Inspector General and as set forth in the Strategic Objective Agreement (SOAG) or a SOAG Implementation Letter. It further adds that the Guidelines should be followed in the selection of auditors and that the auditors should observe the Guidelines in planning, conducting, and reporting the results of the audit.

[3] ADS Glossary defines Host Country Contracting as "A means of program implementation in which USAID finances, but is not a party to, contractual arrangements between the host country and the supplier of goods and/or services." ADS 301.5.1a states that when USAID decides to use host country contracting procedures – it acts as financier and not a contracting party, reserving certain rights of approval and activity monitoring.

Moreover, section 3.9 of the Country Contracting Handbook specifically states that “Final payment to the contractor is withheld until the contractor provides evidence that it has met all of its obligations under the contract and all required certifications (including acceptance of the work by the Contracting Agency) have been executed and the contract has been *audited*, as provided above. The USAID Activity Manager will be notified of contract closeout and contract files will be maintained in storage at least three years from the final disbursement under the SOAG.” (emphasis added)

RIG/Pretoria obtained a list of USAID-funded host country contracts from USAID/Kenya that were active during the fiscal years 2003-2005. Two host country contracts had expenditures over $300,000 and required financial audits that had not been submitted to RIG/Pretoria. Timely financial audits of host country contracts could improve the Mission’s oversight of USAID funds. For example, a host country contract had a financial audit that covered November 1, 2000 to June 30, 2004. The results of the financial audit (Report No. 4-615-06-001-R) showed $2,547 in questioned ineligible costs and $957,435 in questioned cost sharing contributions ($278,044.ineligible and $679,391 unsupported). The Mission could have taken appropriate steps to reduce the amount of questioned costs had financial audits on this host country contract been done on a timely manner.

This occurred because USAID/Kenya’s Mission Order dated May 1, 2002 did not include host country contract procedures for financial audits.

To prevent the omission or delay of host country contract financial audits, we are making the following recommendations:

Recommendation No. 6: We recommend that USAID/Kenya amend its Mission Order dated May 1, 2002 to provide procedures for including host country contracts in award inventories and annual audit plans, as appropriate.

Recommendation No. 7: We recommend that USAID/Kenya obtain and submit audits for the two host country contracts that expended in excess of $300,000 in one fiscal year as required in Section 3.9 of the Country Contracting Handbook.

EVALUATION OF MANAGEMENT COMMENTS

The Mission provided its written comments on May 22, 2006 and additional clarification on June 26, 2006 to our draft audit report which contained eight recommendations.

Evaluation of additional information included in the Mission's revised comments justified the removal of Recommendation No. 6 from the draft report issued on April 19, 2006. The finding stated that host country contracts were not included in the Mission's audit inventories. However, additional clarification provided to RIG/Pretoria on June 26, 2006 showed that the Mission included the individual Implementation Letters related to the host country contracts in its audit inventories. We determined that this finding and the particular recommendation is no longer valid. Therefore, the final report has seven recommendations. References to Recommendation Nos. 6 and 7 below correspond to Recommendations Nos. 7 and 8 in the draft audit report as well as the USAID/Kenya comments found in Appendix II to this report.

USAID/Kenya agreed with Recommendation Nos. 2, 4, 5, 6 and 7, and disagreed with Recommendation No. 1. The Mission provided agreement, corrective action plans, and target completion dates for Recommendation No. 1 and they provided a draft Mission Order for Recommendation Nos. 4 and 6. The Mission neither agreed nor disagreed with Recommendation No. 3, but amended its Mission Order regarding audit management dated May 31, 2006 showing detailed steps involved in the USAID financial audit process. For Recommendation No. 7, the Mission agreed to submit all host country contract audits to RIG/Pretoria. For Recommendation Nos. 1, 3, 4, 6 and 7, management decision has been reached.

USAID/Kenya agreed and provided corrective action plans for Recommendation Nos. 2 and 5; however, the Mission did not provide target dates for completion of action. Therefore a management decision has not been reached. Management decision will be reached once the Mission provides target dates for submitting delinquent audit reports to RIG/Pretoria. Final action will be accomplished when USAID/Kenya submits the audit reports identified in Appendices III and IV to RIG/Pretoria.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General/Pretoria (RIG/Pretoria) performed this audit in accordance with generally accepted government auditing standards. The audit was performed at the Regional Inspector General in Pretoria, South Africa from December 20, 2005 though March 24, 2006.

The audit covered financial audit requirements for USAID/Kenya's awards to non-U.S.-based recipients during fiscal years 2003, 2004, and 2005.

The type of evidence examined during the audit included, but was not limited to, award inventories and audit plans submitted by the Mission for fiscal years 2003-2005, RIG/Pretoria's Audit Management Database and archives, and correspondence from the Mission.

For the most part, we relied on the accuracy and completeness of the award inventories that were submitted by the Mission to RIG/Pretoria because we believe that the responsibility for preparing award inventories rests with the Mission's Audit Management Officer, who should have the technical capacity to prepare reliable award inventories. The primary focus of our audit was the development and execution of the annual audit plans from those award inventories. Thus, with few exceptions, we limited our procedures to determine whether data in the award inventories were properly used to develop the audit plans and whether those audit plans were executed in an acceptable and timely manner. We recognize the limitations of our reliance on the accuracy and completeness of the award inventories, and hereby disclose this in the audit report—the primary limitation being that all awards requiring a financial audit may not have been included in the Mission's award inventories. Further, expiration dates and total amounts of awards in inventories may not have been accurate.

With regard to internal controls, we assessed:

- Award inventories.
- Audit plans.
- Mission orders regarding financial audits.

Methodology

To accomplish the audit objectives, we reviewed and analyzed the annual audit plans and award inventories for fiscal years 2003-2005 submitted to RIG/Pretoria for USAID/Kenya. We compared audit reports actually submitted to RIG/Pretoria to planned audits listed in the Mission's audit plans in order to determine the timeliness of the submission. We compared the audit plans to the award inventories to determine the accuracy of the audit plans. To determine recipients requiring closeout audits, we reviewed the Mission's award inventories and selected awards that were not subject to an annual audit prior to the program completion date. The audit also included a review of correspondence between RIG/Pretoria and the Mission regarding award inventories and annual audit plans. We also requested additional information from the Mission when required.

For materiality thresholds, we considered the following to be material:

- Timeliness of submission of audit reports – if the number of acceptable audit reports submitted after the nine month due date was greater than 10 percent of the number of planned audits, we considered the lack of timeliness to be material.

- Delinquent audit reports – any number of delinquent planned audit reports was considered to be material.

- Completeness and accuracy of audit plans – any number of required audits not included in the audit plans was considered to be material.

This was one of a total of nine similar audits that we are performing of USAID missions within the eastern and southern Africa region. As RIG/Pretoria already possessed most of the information needed to conduct the audits, we did not consider travel to the locations of the respective missions to be necessary. Any questions regarding audit procedures or preliminary results could be handled via e-mail or telephone.

MANAGEMENT COMMENTS

MEMORANDUM

To: Jay Rollins, RIG/Pretoria
100 Totius Street
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0027, Pretoria
South Africa

From: Stephen M. Haykin, Mission Director, USAID/Kenya

Date: May 22, 2006

Subject: Audit of USAID/Kenya's Compliance with Financial Audit Requirements Regarding Foreign Recipients (Audit Report No. 4-615-06-xxx-P)

In response to your transmittal memo dated April 19, the Kenya Mission takes this opportunity to thank RIG/Pretoria for conducting this audit and for highlighting areas for improvement. In addition, we appreciate this opportunity to comment on the audit findings although, in the absence of an exit conference, we would have expected a preliminary draft report for comment prior to issuance of the draft report. We are hopeful that RIG/Pretoria will substantially modify some findings/recommendations and even close others at the draft report level based on the specific comments and supporting evidence USAID/Kenya has provided for each of the eight recommendations as discussed below.

Recommendation No.1: We recommend that USAID/Kenya develop and implement an audit tracking system to monitor the recipient financial audit process to ensure timely submission of reports to RIG/Pretoria. This system should at a minimum, include controls to ensure that:

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- Appropriate timing targets and milestones are set for each audit in the Mission's current audit plan;
- Audit instructions are sent to recipients prior to the recipient's fiscal year-end requesting them to initiate the procurement process for the audit;
- Periodic follow-up is performed to determine the implementation status of all planned audits; and Corrective actions are taken and documented for audits that are not progressing as planned.

USAID/Kenya's comments: The Mission does not agree with the finding that it does not have an audit tracking system. Please see the Mission's tracking system that it has been in use (Attachment 1).

However, the Mission agrees that its current tracking system can be improved to more effectively ensure the timely performance and completion of financial audits. In this regard and in response to the recommendation's three sub-sections:

- The Controller's Office has instituted additional controls with timing targets and milestones for each audit to be part of the Mission's audit monitoring plan (see Attachment 2).

- Starting this month, as appropriate, the Mission will send out its audit notification letter (see Attachment 3) to all organizations in the audit plan three months before their respective financial year-ends to ensure timely initiation of the audit process.

- The Mission will continue to use the quarterly financial activity and the audit performance tracking reports showing the status of audits. In addition, review of audit status will be included in agendas for the weekly SO staff meetings and monthly SO meetings with the Mission Director; Financial Analysts will take the lead towards this end. Further, the Controller's Office will document and share the results of these meetings both internally and with partners, and maintain a permanent record in the audit files.

Recommendation No.2: We recommend that USAID/Kenya obtain and submit all delinquent audit reports to RIG/Pretoria.

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USAID/Kenya's comments: USAID/Kenya is following up on the outstanding audits (Appendix III of the Audit report No. 4-615-06-XXX-P) will submit the reports as soon as they are ready.

Recommendation No.3: We recommend that USAID/Kenya develop and implement a system to ensure that the Mission reviews, approves and maintains a copy of an audit agreement containing a standard statement of work that incorporates USAID's audit requirements for every recipient audit.

USAID/Kenya's comments: This system has been in place since the Mission received from RIG/Pretoria a schedule (see Attachment 4) showing the detailed steps involved in the USAID financial audit process. Therefore, the Mission has on file copies of audit agreements containing standard statements of work for all audits since that time, including Egerton University, Kenya Agricultural Research Institute, ICROSS, Institute of Civic Affairs and Development, etc). In addition, starting immediately, the Mission will forward to RIG/Pretoria copies of SOWs and Mission approvals together with the respective audit reports as they are completed.

Recommendation No.4: We recommend that USAID/Kenya amend its Mission Order dated May 1, 2002 to ensure that closeout audits of expiring awards in excess of $500,000 are included in future audit plans and performed as required.

USAID/Kenya's comments: The Mission agrees with this recommendation and has already incorporated the recommended change in a revised Mission Order that awaiting the approval by the USAID/Kenya and USAID/EA Directors (see Attachment 5).

Recommendation No.5: We recommend that USAID/Kenya obtain and submit audit reports for all expired awards requiring closeout audits.

USAID/Kenya's comments: The Mission agrees with this recommendation and has initiated actions to obtain and submit audit reports for the expired-awards requiring closeout audits (see Attachment 6). As further shown in Attachment 6, USAID/Kenya has identified awards that are already on its FY 2006 Audit Plan and those that do not require closeout audits.

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Recommendation No.6: We recommend that USAID/Kenya include all identified host country contracts in its award inventory for fiscal year 2006.

USAID/Kenya's comments:[4] The Mission disagrees with this recommendation. The agreements included in the audit schedule (Appendix V) are Development Assistance Grant Agreements (DAGAs; variously called SOAGS) which are bilateral agreements. The GOK activities funded by USAID/Kenya are then funded under the DAGAs. Where the recipients under the DAGAs spent more than US$300,000 they would be subject to RCAs. These activities do appear on the USIAD/Kenya's Audit Inventory and Audit Plan (as appropriate). These activities are the auditable entities and not the DAGAs. In addition, the Mission would like to clarify that these are not host country contracts because if where the GOK is involved in contracting, the Mission takes active part in the process and in most cases makes payments direct to the contractors. USAID/Kenya is carrying several procurement assessments of Government of Kenya Agencies before it formally enters into Host Country Contracts.

Recommendation No.7: We recommend that USAID/Kenya amend its Mission Order dated May 1, 2002 to provide procedures for including host country contracts in award inventories and annual audit plans, as appropriate.

USAID/Kenya's comments: The Mission agrees with this recommendation and has already incorporated the recommended change in a revised Mission Order that is awaiting the approvals the USAID/Kenya and USIAD/EA Mission Directors (see attachment 5). All future Host-Country audits are provided for under the revised Mission Order.

Recommendation No.8: We recommend that USAID/Kenya obtain and submit audits for the two host country contracts that expended in excess of $300,000 in one fiscal year as required in Section 3.9 of the Country Contracting Handbook.

USAID/Kenya's comments: USAID/Kenya would like to clarify that none of the instruments listed in the audit report under Host Country audits (Appendix V) are directly subject to audit as required in Section 3.9 of the Country Contracting

[4] Additional clarification from USAID/Kenya provided justification for removal of Recommendation No. 6. Therefore, the Mission's response for Recommendation Nos. 7 and 8, respectively applies to Recommendation Nos. 6 and 7 of this report.

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Handbook. In addition, we were unable to identify the two instruments referred to in this recommendation to enable us make a more response as to whether the audit process or plans are under way to perform the audits within the due dates.

Please feel free to contact us for any further information or clarification.

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LIST OF DELINQUENT AUDITS AS OF DECEMBER 31, 2005

	Award Number[5]	Recipient's Fiscal Year End	Total Amount of Award ($)	Estimated Annual Expenditures ($)	# of Days Between Audit Report Due Date and 12/31/05
1	Various Comm. Docs	6/30/2002	8,500,000	1,008,154	1,005
2	Various Comm. Docs	12/31/2001	689,359	44,170	1,187
3	CO623-C-00-00-00136	9/30/2002	1,134,923	409,919	914
4	GR623-A-00-00-00097 and GR623-A-00-99-00097	9/30/2003	3,779,737	-	548
5	Various	6/30/2003	3,765,355	500,500	639
6	PIL615-005-003	6/30/2003	1,000,000	400,000	639
7	GR623-A-00-01-00004	3/31/2003	466,140	332,423	731
8	PIL615-0268-32	6/30/2003	3,173,820	550,000	639
9	PIL615-0268-32,	6/30/2004	5,168,766	795,934	274
10	PIL615-0268-041	6/30/2003	594,400	-	639
11	PIL615-0268-041& 7-003	6/30/2004	979,790	348,807	274
12	Various	6/30/2004	3,765,355	210,253	274
13	GR623-A-00-00-00097 and GR623-A-00-99-00097	6/30/2004	3,779,737	900,000	274

[5] Award numbers have been presented as they appear in the Mission' award inventories.

LIST OF EXPIRED AWARDS REQUIRING CLOSEOUT AUDITS

	Award Number[6]	Award Expiration Date	Total Amount of Award (in US $)	# of Days Between Audit Report Due Date and 12/31/05
1	CO623-A-00-97-00039	12/31/2002	962,857	822
2	PIL615-0268-024	6/30/2003	1,351,837	639
3	COG623-0263-A-00-7015	6/30/2001	1,625,169	1,370
4	PIL615-0268-25	6/30/2003	794,795	639
5	GR623-A-00-01-00132	12/31/2003	680,000	457
6	GR623-G-00-99-00044	12/31/2001	876,000	1,187
7	GR623-G-00-99-00036	12/31/2002	1,400,000	822
8	COAG623-A-00-03-00041	12/31/2005	750,000	-274[7]
9	GR623-G-00-00-00155	12/31/2003	523,390	457
10	CA623-A-00-03-00038	12/31/2004	999,808	91
11	GR623-A-00-01-00132	12/31/2004	680,000	91
12	PIL615-0268-024, 047	6/30/2004	1,351,837	274
13	GR623-G-00-99-00293 and GR623-G-00-01-00127	12/31/2004	814,859	91
14	IL-615-0006-005	6/30/2005	715,697	-90[7]
15	IL615-0006-004	12/31/2004	622,281	91
16	IL615-003-003	12/31/2004	1,140,000	91
	Total		15,288,530	

[6] Award numbers have been presented as they appear in the Mission' award inventories.
[7] These audit reports were not yet due as of December 31, 2005, however, they should be included in the Mission's respective audit plan.

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