OFFICE OF INSPECTOR GENERAL

Audit of the African Development Foundation's Financial Statements for Fiscal Years 2006 and 2005

AUDIT REPORT NO. 0-ADF-07-002-C
November 15, 2006

WASHINGTON, DC

Office of Inspector General

November 15, 2006

MEMORANDUM

TO: ADF President, Rodney MacAlister

FROM: AIG/A, Joseph Farinella /s/

SUBJECT: Report on Audit of the African Development Foundation's Financial Statements for Fiscal Years 2006 and 2005 (0-ADF-06-002-C)

Enclosed is the final report on the subject audit. We contracted with the independent certified public accounting firm of Leonard G. Birnbaum & Company, LLP (LGB) to audit the financial statements of the African Development Foundation as of September 30, 2006 and 2005 and for the years then ended. The contract required that the audit be performed in accordance with generally accepted government auditing standards; generally accepted auditing standards; Office of Management and Budget (OMB) Bulletin 06-03, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency Financial Audit Manual.

In its audit of the African Development Foundation (ADF), LGB found that;

• the financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles,

• ADF had effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations,

• ADF's financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA), and

• no reportable noncompliance with laws and regulations it tested.

In connection with the audit contract, we reviewed LGB's report and related documentation. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on ADF's financial statements or internal control or on whether ADF's financial management systems substantially complied with FFMIA; or conclusions on compliance with laws and regulations. LGB is responsible for the attached auditor's report dated November 3, 2006 and the conclusions expressed in it. However, our review disclosed no instances where LGB did not comply, in all material respects, with applicable standards.

The report does not contain recommendations. ADF comments to the auditor's report are included in Appendix I.

The OIG appreciates the cooperation and courtesies extended to our staff and to the staff of LGB during the audit. If you have questions concerning this report, please contact Andrew Katsaros at (202) 712-4902.

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AFRICAN DEVELOPMENT FOUNDATION

PERFORMANCE AND ACCOUNTABILITY REPORT

FISCAL YEAR 2006

Leonard G. Birnbaum and Company, LLP
6285 Franconia Road
Alexandria, VA 22310
(703) 922-7622

AFRICAN DEVELOPMENT FOUNDATION
MESSAGE FROM THE PRESIDENT

It gives me great pleasure to report that FY 2006 has been a very successful year for the African Development Foundation (ADF). Since beginning my tenure as the President of ADF, in February of this year, I have become increasingly impressed with ADF's track record of delivering on its mandate to help the poorest of the poor in Africa. ADF is an agency that knows how to accomplish its mission.

Even the most efficient agency can make improvements, and I saw some areas that I wanted to address as soon as I arrived. One of the most important initiatives I put into place as soon as I took office was an updated, revamped safety and security policy that applies to our field operations as much as to our headquarters. The health and safety risks associate with ADF's line of business cannot be overstated. As the agency head, I believe it is my duty to ensure to the extent possible that everyone in the extensive ADF family enjoy and safe and healthy work environment. The new policy is innovative and progressive, bringing best practices to our clients and customers as well as our staff.

Another important initiative undertaken this fiscal year is the creation of the Africa Regional Office (ARO) in Accra, Ghana. Headed by a seasoned ADF senior manager, the ARO, when fully staffed, will provide essential on-the-ground assistance to field staff and grantees. With so much of ADF's methodology predicated on working with grantees all along the way, having a presence on the continent is absolutely essential.

ADF fosters hope, growth and goodwill in Africa. Its programs advance two major U.S. Government (USG) objectives:

- stimulating Africa's economic growth, particularly in terms of building on the success of the Africa Growth and Opportunity Act (AGOA); and
- consolidating progress in fragile states.

Furthermore, ADF's major country programs align with those African countries that the Administration has identified as USG priorities.

- In Nigeria, Ghana, Zambia, Tanzania and Uganda, ADF concentrates its investment to develop small and medium-sized, African-owned enterprises and to help small farmers diversify production into high value cash crops for the global market.

- In Liberia and Rwanda, ADF's programs foster hope and promote growth needed for peace and stability.

- In Guinea, Northern Nigeria, Mali, Niger, Senegal, ADF's programs help advance the Administration's efforts to foster goodwill with predominately Muslim countries and alleviate poverty as a breeding ground for radical Islamic fundamentalism.

ADF has proven its effectiveness and demonstrated its uniqueness and impact. We had some noteworthy accomplishments during this past year.

- We are nimble and have shown how we can quickly respond to USG priorities. Within 13 days of being invited by the new Head of State of Liberia to consider opening a program there, and with the encouragement of the President's National Security Advisor for Africa, ADF was on-the-ground planning for a new country program. In less than six months, we established in-country operations and have designed and funded eight projects to help rebuild the Liberian private sector and demonstrate the responsiveness of our government.

- ADF was rated as fully "effective" by OMB in the PART assessment, the highest rating available, which is received by only 11 percent of all USG agencies and only five percent of grant programs. Nonetheless, we are not "resting on our laurels"; ADF's Board of Directors is committed to further strengthening our program performance and operations. Towards that end, ADF undertook a fundamental restructuring and set up its African Regional Office in Accra, Ghana, this year.

- ADF continues to demonstrate that it can help small African producers take advantage of AGOA and access global markets with quality products. Under our new Buyer Linkages Program, women in both Ghana and Tanzania are producing baskets that will be featured in Target stores across the United States as part of their annual "Global Bazaar." Similarly, we are negotiating with Cargill to buy organic cotton from smallholders supported by ADF in Zambia.

- As a testimony to its effectiveness, ADF continues to expand its strategic partnerships with African governments and private companies, requiring matching contributions for all new country programs. No other relief or development agency can boast of such an approach being central to its business model. It not only maximizes the impact of USG resources, but it also provides ADF opportunities to influence African development priorities and to encourage greater corporate social responsibility. This year, ADF entered into two new partnerships, worth $2.0 million annually, with multinational corporations involved in extractive industries.

The African Development Foundation is an integral part of achieving U.S. priorities in Africa. ADF has produced significant results, with relatively small appropriations. The Foundation is being recognized – within the development community, in the Administration, and in Congress – as one of the most distinctive and effective foreign assistance programs we have. Moreover, it serves as a powerful example of both the compassion and the innovation of the American people.

I am pleased to submit the FY 2005 Performance and Accountability Report for the African Development Foundation (ADF). The financial statements and the performance results data are complete, reliable and in accordance with the Office of Management and Budget (OMB) requirements and in conformity with generally accepted accounting principles. ADF has appropriate management controls in place to ensure that all internal controls are operating in accordance with applicable policies and procedures and are effective in meeting the requirements imposed by the Federal Managers' Financial Integrity Act (FMFIA) and the Federal Financial Management Improvement Act (FFMIA).

Signed:

/s/

Rodney J. MacAlister
President

AFRICAN DEVELOPMENT FOUNDATION
MANAGEMENT'S DISCUSSION AND ANALYSIS

About the African Development Foundation

Congress established the African Development Foundation (ADF) in 1980 as a U.S. Government corporation dedicated to promoting grassroots development in Africa. ADF provides grants to private enterprises and other non-governmental organizations in Africa. The usual maximum grant size is $250,000, but ADF can fund larger projects as rare exceptions, with the approval of the Board of Trustees and notification of Congress. The usual maximum grant duration is five years, but may extend to seven years in some circumstances. ADF

- Finances sustainable poverty alleviating initiatives that are conceived, designed, and implemented by Africans and aimed at enlarging opportunities for community development;
- Expands the participation of Africa's poor in the development of their countries; and
- Builds sustainable African institutions that foster development at the grassroots level.

The African Development Foundation mission is to "grow" small African businesses and empower local communities to take control of their own development – from the bottom-up. Its assistance enables informal enterprises to move into the formal economy, small businesses to grow into robust enterprises that can produce high quality products as substitutes for expensive imports and for regional and global markets, poor farmers to produce nontraditional high-value cash crops, and capture additional revenue through processing prior to export.

The agency's program is highly complementary to other USG development assistance, but ADF's model is unlike any other currently in the market.

- ADF's approach is rigorous and holistic; it works with the prospective clients to assess all aspects of its operations, diagnose constraints, identify growth opportunities, and then provides a comprehensive, integrated package of investment capital, technology, training, technical assistance and market support tailored to a specific enterprise or industry.
- ADF uniquely blends the strongest aspects of private sector venture capital and donor philanthropy in its approach. Its small grants do not over-extend a growing business too soon.
- ADF initiated the concept of the "community reinvestment grant" or CRG. Grantees commit to reinvesting a portion of their profits to support community development projects. This required contribution to a local development trust provides a strong commercial orientation to ADF's support, and it enables the grantee to establish "credit-worthiness" to subsequently access commercial credit.

- Working directly with the enterprise, rather than through government agencies or international nongovernmental organizations (NGOs), private voluntary organizations (PVOs) or consulting firms, means that 100 percent of the grant goes directly to the recipient.

As the international community rallies to help reduce poverty and promote broad-scale economic growth in Africa, it is recognized that all too little of external funding is actually getting to the grassroots. In contrast, the African Development Foundation can demonstrate tangible, measurable outcomes, which are *directly* attributable to its support. ADF grows sustainable, indigenous businesses that have an economic impact that far surpasses the original value of the grant.

The Foundation has made year-on-year improvements in virtually all key program performance indicators. As a testament to the Foundation's sound strategic planning, effective performance management, and consistently strong results, the Office of Management and Budget rated the agency fully "effective," after completing the comprehensive Program Assessment Reporting Tool (PART) in FY 2005. This is its highest rating and is a significant accomplishment, given that only 11 percent of federal agencies, and a mere 5 percent of grant-making programs, receive it. (ADF's PART assessment for FY 2006 is not included here because the ratings process had not been completed at the time of printing.)

One aspect of ADF's program structure that makes it significantly different from other development agencies is its strategic partnership program. Because of the Foundation's high impact and unique approach, both African governments and large, socially responsible corporations are seeking to partner with ADF and contribute their own capital funds to the Foundation to match appropriated funding. The Foundation already has signed Memoranda of Understanding with a dozen entities to contribute a total of $13.5 million. ADF has received five additional partnership proposals, which it expects to conclude during FY 2007, totaling $5.0 million more. As a result of these strategic partnerships, ADF leverages a 1:1 match in funding for the virtually all of its projects. This is not "parallel funding;" these are outright contributions made to the U.S. Government. Thus, ADF effectively doubles appropriated dollars through these partnerships.

During FY 2006, the Foundation's Board of Directors and management have undertaken several important steps to enable the agency to operate more efficiently:

- Created a new management structure for headquarters and is now instituting a carefully redesigned field structure, to strengthen all aspects of operations and to ensure that leadership and management are closer to our field operating units;
- Developed a new grant mechanism to support business start-ups and fledgling companies and a "step-up" approach for incrementally growing businesses;
- Formulated a new corporate strategy that provides a stronger, clearer program focus and reflects the Foundation's unique purpose, mandate and approach;
- Devised a classification of countries to prioritize programming; and
- Revised almost all ADF policies and procedures to enhance efficiency and effectiveness.

Performance Highlights

ADF's performance results for FY 2006 will not be available until the end of November. Because ADF provides grants to small African entities that are often located in remote locations, the task of gathering and analyzing fiscal year end performance data cannot be achieved in time for publication in the PAR. A detailed discussion of the FY 2005 performance targets and results is located in the performance section, below.

Comparative information on performance results from FY 2001 through FY 2005 is provided below:

Performance Result Trends, Five-Year Trends (cumulative numbers for active projects)

Performance Indicator	**FY 2001**	**FY 2002**	**FY 2003**	**FY 2004**	**FY 2005**
Enterprises assisted	47,049	86,180	80,946	95,176	108,341
Owners and full-time workers in assisted enterprises[1]	36,457	96,854	112,802	115,827	114,597
Women as a percent of owners and workers in assisted enterprises[2]	56.8%	58.1%	48.2%	75.6%	At least 64.9%
Enterprises with loans[3]	54,099	65,319	67,893	84,925	Indicator discontinued
Cumulative value of loans disbursed	Indicator not in use	$11.243 million	$15.127 million	$17.250 million	$22.790 million
Proportion of loans for women[4]	50.8%	60.6%	61.8%	73.2%	Indicator discontinued
People receiving business management or technical training[5]	66,126	Indicator discontinued	Indicator discontinued	Indicator discontinued	Indicator discontinued
Women as a percent of people receiving business management or technical training[5]	26.3%	Indicator discontinued	Indicator discontinued	Indicator discontinued	Indicator discontinued
Cumulative sales revenues from active enterprise projects[6]	$17.457 million	$53.440 million	$28.830 million	$43.485 million	$54.836 million
Net income of grantees during the year[6]	$10.528 million	$14.611 million	$6.369 million	$8.807 million	$4.598 million

[1]Unless actual data were available from grantee records or surveys to support higher numbers, the most conservative assumption was adopted -- that there was one owner/worker per enterprise assisted. The actual number for many projects is likely to be substantially higher than the reported number.
[2]In the absence of information on the gender of the owners and workers, the proportion of women beneficiaries was assumed to be zero. The actual proportion of women beneficiaries is

likely to be substantially higher.
[3]In FY 2001, the indicator tracked the number of loans, rather than the number of enterprises receiving loans. Since microfinance projects typically provide multiple loans to an enterprise, the current indicator produces lower numbers than the previous indicator and is a more meaningful measure of program outreach.
[4]This indicator was modified from the proportion of the number of loans that went to women to women's proportion of the total value of loans, which is a better measure of gender equity.
[5]This indicator was discontinued since it is not a measure of program results.
[6]For FY 2002 through FY 2004, gross revenues and net income of grantees included the income received by microfinance institutions. In FY 2005, ADF decided to stop including the income of microfinance institutions in gross revenues and net income to focus only on enterprise revenues. If the definitions from previous years had been retained, the gross revenues and net income in FY 2005 would have been higher than reported here.

Performance Result Trends, Five-Year Trends -continued

Performance Indicator	**FY 2001**	**FY 2002**	**FY 2003**	**FY 2004**	**FY 2005**
Export products promoted[1]	4	19	Indicator discontinued	Indicator discontinued	Indicator discontinued
New production and export trade arrangements established[2]	18	Indicator discontinued	Indicator discontinued	Indicator discontinued	Indicator discontinued
Cumulative export sales revenues from active enterprise projects	Indicator not in use	$7.594 million	$12.027 million	$21.530 million	$33.801 million
People receiving AIDS prevention training	35,483	274,041	282,089	320,509	Indicator discontinued
Women as a percent of people receiving AIDS prevention training[3]	57.0%[3]	66.8%	64.9%	66.7%	Indicator discontinued
Partner organizations assisted	14	13	13	13	13
Host governments or donors providing funding for strategic partnerships	2	4	1	6	6
Funds from strategic partnerships[4]	$0.364 million	$1.104 million	$0.455 million	$2.704 million	$3.541 million

[1]This indicator was discontinued as a quantitative performance measure since a larger number is not necessarily better than a more focused program and there were inconsistencies in whether grantees lumped similar products together or split them into more specific categories.
[2]This was discontinued as a quantitative performance measure since a larger number is not necessarily better and there were definitional issues about what constitutes a new production or export trade arrangement.
[3]To produce a conservative estimate of gender equity, it was assumed that all of the beneficiaries were men if no gender-disaggregated data were available. The actual proportion of women among these beneficiaries is likely to be substantially higher than reported.
[4]In FY 2005, the indicator was changed from funds leveraged by strategic partnerships (which may not be received until the following year) to funds received from strategic partnerships during the year.

ADF Operations

ADF's operating environment presents many challenges. Ensuring that grantees receive timely disbursements is one is one such challenge. All grantees are required to establish separate bank accounts for their ADF grants. Once a disbursement request is approved, the funds are electronically transferred, in local currency, directly to the grantee's bank account. Because a number of intermediary banks may be involved in the process, the time between the release of funds from the U.S. and the posting of funds to the grantee's account can be inordinately long.

To help our grantees receive their funds as quickly and efficiently as possible, we document the flow of funds with written confirmations as the funds move through various financial institutions until they reach the grantee's bank. Then, on those occasions when the posting of the grantee's funds is delayed, he/she can go directly to the bank, armed with the thorough documentation of the transaction that we provide, and request that the funds be posted immediately. With this monitoring system, our grantees receive timely payments virtually all the time.

ADF's grantees are located in over 15 countries, often in remote locations. Effective communication can be difficult, especially in countries where telecommunications systems are not reliable. While ADF has an extensive field network working directly with grantees and ensuring that grantees provide quarterly financial and performance reports, communicating this information back to ADF Washington can be challenging. During FY 2006, ADF implemented an updated, web-based grant information system. This will allow local staff to input project-related directly into the database, which can then be used by headquarters staff to measure project performance on a much more timely basis.

ADF Quality Assurance, Internal Controls and Legal Compliance

During 2006, ADF made additional improvements in internal controls. Building on the improvements made to the grant and cooperative agreement audit program in FY 2005, ADF implemented further refinements this year. ADF restructured its auditor position and filled it with a highly qualified certified public accountant with a strong government auditing background. The auditor manages the audit program for project grantees, determines which projects will be audited, defines the scope of work required for each audit, evaluates the performance of contracted auditing firms, and authorizes payment to contracted auditing firms. Based on the ADF auditor's thorough review of grantee audit results, the agency's Audit Committee is informed of any material issues raised by the audit firms. These issues are then tracked by the portfolio managers responsible for the grantees in question to ensure timely follow up.

As a small agency, ADF has always had strong internal controls. Managers and staff work closely on all aspects of program management. The relatively small number of transactions has allowed for 100 percent review and audit virtually all transactions, including travel vouchers, disbursement requests, and procurements. Nevertheless, in FY 2006, the auditor began a major initiative to assess risk, test controls, evaluate their effectiveness, and recommend improvements to ADF's internal control systems. These actions will not only ensure that ADF has a strong system in place but will also allow for potential procedural improvements that will lead to a more efficient use of ADF's limited resources.

ADF's grants database has a full time Grants Database and Operations Manager, who is the primary person responsible for the continued integrity and security of all grantee administrative and financial data reported. The financial information contained in the database is reconciled monthly with the financial information contained in the agency's core financial system, Oracle Federal Financials. During the fourth quarter of FY 2006, ADF implemented an updated grants database with significantly enhanced features. Because the system is web based, ADF's regional offices will have access to real time information.

A key to the success of ADF's methodology is the hands-on approach we take with every grantee. As soon as grantees receive their first disbursement, the portfolio managers in the Management Division begin monitoring the grantees that have been assigned to them. They take an active role in monitoring budget execution, approving disbursements, approving budget shifts, reviewing expenditure reports, making adjustments to the timing of grantee activity, and even recommending suspension and termination, if the need should arise.

In FY 2005, ADF eliminated all long-standing material weaknesses related to its core financial system. ADF's systems are now fully compliant with all OMB and Treasury requirements.

Identification of Key Factors That Could Affect Achievement of General Goals and Objectives

ADF's programs are designed to assist "the poorest of the poor in Africa." Our mandate is to build a broad base for sustainable economic development in Africa, thereby enabling the people of Africa to break the vicious cycle of poverty. There are a number of factors that could affect program goals and objectives. These factors include poor communication systems, poor infrastructure, unsuitable health conditions, poverty, the threat of civil strife, and political instability, just to name a few. Despite these challenges, ADF projects have proven to be highly successful.

Comments on Financial Statements

ADF is pleased to report that in FY 2006 the Foundation continued to receive an unqualified opinion on all five financial statements from its independent auditors Leonard G. Birnbaum and Company, and the USAID Office of the Inspector General. Since FY 2001, ADF has received an unqualified opinion on the Balance Sheet, the Statement of Net Costs, the Statement of Net Position, the Statement of Budgetary Resources, and the Statement of Financing.

Cost of Operations

Costs associated with program activities increased 7 percent, from $12 million in FY 2005 to $12.9 million in FY 2006. The increase relates primarily to an increase in grantee expenses. This is an expected result from prior year increases in appropriations and donations from strategic partners. As the number of grants supported grows, expenses will increase gradually over the average five-year period of the typical ADF grant.

Operating expenses increased as well. This is primarily due to a combination of factors including, additional staffing, higher payroll costs due to COLAs and with-in grade increases, additional technology expenditures, and the establishment of the ADF Africa Regional Office in Accra, Ghana.

Appropriations

ADF's appropriations are available for two years. Appropriations increased from $19 million in FY 2005/2006 to $23 million in FY 2006/2007. While obligations incurred were consistent between FY 2005 and FY 2006, the impact of the increase for FY 2006/2007, will be seen in FY 2007, when ADF will use the carryforward funds for additional grant obligations.

Limitations of Financial Statements

ADF's principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b).

While the statements have been prepared from books and records in accordance with generally accepted accounting principles (GAAP) for federal entities and the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

AFRICAN DEVELOPMENT FOUNDATION
ANNUAL PERFORMANCE INFORMATION

ADF has clearly articulated purpose, vision and mission statements:

Purpose: Fostering hope, growth and goodwill in Africa
Mission: To be a leader in promoting high impact activities and innovative approaches to improve the lives of Africans.
Vision: To stimulate grassroots development and empower the poor in Africa by growing profitable businesses and sustainable social enterprises.

ADF's strategic goals and objectives are designed to ensure that there is a system in place to track and measure agency performance against the purpose, mission and vision.

ADF's Program and Strategic Goals and Objectives

Goal I: Invest in small businesses and social enterprises that create jobs, generate income, and improve the lives of the poor.

Despite recent, impressive growth and development, sub-Saharan Africa still lags behind all other regions of the world. Every significant socio-economic indicator (GNP per capita, life expectancy, infant and child mortality, adult literacy, primary and secondary school enrollment, total fertility) shows that the welfare of the people of Africa is still significantly worse than every other region.

ADF funds projects that directly and significantly improve the livelihoods of low-income people. The Foundation stresses innovation and rigor in its projects to create jobs and increase incomes for the poor. ADF seeks to stimulate growth on a large scale by demonstrating successful models that can be replicated by African governments, large bilateral and multilateral donors, and private voluntary organizations.

Strategic Objective 1: *Enhance the growth of African- owned small and medium size enterprises, improve their access to investment, and increase their participation in regional and international trade*

"Trade is the great engine of economic progress…
The peoples of Africa have been left out long enough."

President George W. Bush

Building on more than 20 years of experience in grassroots development, the Foundation has formulated a high impact strategy to help small and medium sized, African-owned enterprises grow, develop new products, and take advantage of opportunities in both the local and global markets.

SMEs play two crucial roles in Africa's economic development:

- Smaller businesses and agricultural producer groups provide a high percentage of employment of the poor.
- A more limited set of SMEs has the potential to grow rapidly into globally competitive companies that can add value to Africa's exports and provide low-cost goods and services to Africa's domestic markets.

The African Growth and Opportunity Act of 2000 (AGOA) specifically notes the important role of ADF in developing and implementing strategies for promoting participation of small-scale enterprises and informal sector groups such as farmer cooperatives and artisans in trade and investment activities. ADF's investment in growing African businesses and promoting their participation in trade is distinct but highly complementary of assistance provided by USAID and the Millennium Challenge Corporation.

ADF helps applicants conduct thorough assessments of their business constraints and opportunities and then assists them to develop their funding proposals into business plans with full financial projections, marketing strategies, training plans, and implementation plans. ADF provides them an *integrated* package of investment capital, training, and technical, managerial and marketing assistance. Once a project is funded, ADF provides assistance in implementation, upgrading of management information systems, monitoring, and reporting through its network of non-governmental Partner Organizations in Africa. More specialized African technical service providers are brought in where necessary.

Through its *direct* assistance, ADF is helping small and medium sized, African-owned enterprises grow, develop new products, and take advantage of opportunities in both the local and global markets. The Foundation's holistic approach is supporting AGOA objectives and demonstrating that small-scale African enterprises and cooperatives can diversify production, meet international standards, and successfully compete in the global economy.

ADF has on-going trade and investment (T&I) programs in Uganda, Tanzania, Namibia, Ghana and Zambia, focused on assisting small-scale enterprises and cooperatives to produce, process and export more than two dozen products, including clothing and fabric, silk, dried fruit and juices, vegetables, processed grains and legumes, meats, hides and leather products, butter, fish products (for example Nile perch and rock lobster), various spices (paprika, chili peppers, vanilla), honey, sugar, tea, coffee, sea salt, ceramics, and solar-powered hearing aids. Many of these products are certified organic and, consequently, fetch a premium price for the producer.

ADF has developed a business model that has uniquely positioned the agency as a leading catalyst for enterprise development in Africa. This includes the following:

- Deep on-the-ground operations.
- Country specific investment strategies
- Industry-specific investment strategies
- An integrated package of technical, marketing and managerial assistance and funding
- Commercial discipline through reimbursable grants
- Host government matching, dollar-for-dollar contributions
- Private sector partnerships

In FY 2006, ADF funded 32 new small and medium-sized enterprise projects, and 22 new trade and investment projects in 10 countries for a total of $6.8 million.

Strategic Objective 2: *Expand small farmer production of high value crops, value-added processing of agricultural goods, and access to local and global markets*

Poverty in Africa is most pervasive in rural areas. With as many as three quarters of the populations in many African countries depending on agriculture for their livelihood, the sector is truly the backbone of most economies. Enabling small farmers to move from subsistence farmer to production of high value cash crops has tremendous impact on improving the lives of Africa's poor, the rural economy, and even the environment. It provides rural families with sorely needed reliable employment and better incomes. This enables them to buy fertilizer to increase productivity of staple crops, purchase food they cannot grow, pay school fees and medical costs, and improve clothing and shelter. Moreover, the agriculture sector has extensive forward and backward linkages within African economies, so it can provide a significant stimulus to growth and stability, in rural and urban areas, in formal and informal enterprises.

ADF is stimulating economic growth in rural economies by:

- Identifying non-traditional high-value crops that have potential on regional and international markets
- Supporting their production by small-scale farmers through provision of training, technical assistance and seasonal agricultural credit;
- Establishing or expanding small-scale agro-processors, through operating capital and equipment procurement, and providing them technical and managerial assistance to ensure they meet market standards; and
- Creating new export marketing linkages for regional or international trade
- By thus working in all phases from farm to consumer, ADF is teaching the principles and practices of modern value chain management.

To make export production that benefits low-income producers more feasible, ADF often works with producer associations or cooperatives that bulk up the production of small-scale producers and carry out processing and/or marketing activities on their behalf. Producer associations and cooperatives can channel other support to small-scale producers effectively, for example through lower cost production inputs through bulk purchases, extension services, market and price information, and greater bargaining power in price negotiations.

In FY 2006, ADF funded 37 new projects involved in agricultural production or processing in 11 countries for a total of $4.4 million. A portion of these projects with an agricultural orientation also fall into the small and medium-sized of trade and investment classification.

Strategic Objective 3: *Promote innovative community-based solutions to critical social and economic needs of marginalized communities and peoples.*

Strategic Objective 4: *Create renewable pools of local capital to fund small businesses and community initiatives.*

Strategic Objectives 3 and 4 work together in finding ways to establish programs within the community to deal with pressing issues defined by the community. To achieve these two objectives, the Foundation has initiated a Community Reinvestment Grant (CRG) program, whereby grant recipients commit to reinvest a portion of their profits into community development projects within their country. Depending on the level of profitability, the grantee pledges to contribute up to the full value of the ADF grant. The CRG provides a strong "commercial" orientation to ADF's grant program, and it also nurtures a culture of social responsibility among for-profit businesses in Africa. CRG contributions produce a multiplier effect for ADF's initial investment by creating a renewable pool of local capital.

The Foundation is providing intellectual leadership through this innovation. For example, the International Finance Corporation of the World Bank invited ADF to share its approach and experience to help it launch a new initiative focused on promoting "social enterprises." In Uganda, ADF, its Partner Organization and the Rockefeller Foundation are jointly undertaking a joint investment program funded, in part, from resources generated under ADF's program trusts.

Goal II: Expand local capacities to support small businesses and social enterprises

Conventional ways of stimulating economic development through huge infrastructure, large-scale industries, or expensive international consulting firms have yielded too little benefit for too few people at high financial and environmental costs. Projects administered by government agencies and parastatal companies are often inefficient and ineffective. By contrast, ADF works directly at the grassroots level with private enterprises, producer groups, and community organizations that assist them.

ADF has extensive experience in participatory, grassroots development strategies that are appropriate for the types of clients most under-served by conventional foreign aid programs. In addition to the direct impact of ADF-funded grants on project beneficiaries, ADF strengthens African institutional and financial capacities to support and sustain grassroots development. It also seeks to multiply benefits by influencing how government agencies, bilateral and multilateral donors, development banks, and non-governmental organizations foster economic development.

Strategic Objective 1: *Build sustainable development organizations and business advisory services that provide technical assistance and training to enterprises and community groups*

ADF's experience in grassroots development showed that there was a great need for local, African institutions and professionals able to provide high quality, reasonably priced technical assistance and training to enterprises and community groups. Consequently, during the past four years, ADF has pursued a unique business model to provide support to its applicants and grantees. In most countries where it operates, the Foundation is investing in developing the capacity of indigenous nongovernmental organizations, which serve as its "Partner." They help applicants that have passed the initial screening done by an ADF Country Representative to develop their project ideas into business plans with rigorous financial analyses. After ADF awards a project grant, the Partner Organizations train the grantees in financial management and participatory monitoring, visit them regularly to monitor progress and help rectify any implementation problems, and provide assistance in procurement and in preparation of quarterly financial and performance reports.

ADF transfers U.S. development expertise to its African Partner Organizations through training and technical assistance to build their capacity. It also monitors the quality of their services and helps them plan and develop systems for attracting future funding from other sources. ADF's cooperative agreements with Partner Organizations were awarded based on an open, competitive grant process; they are performance-based and renewable annually for up to five years.

ADF's Africa Regional Office is working closely with the Partner Organizations to strengthen their capacities and help them develop self-financing plans.

In FY 2006, ADF funded 14 Partner Organizations and technical assistance providers for a total of $4.8 million.

Strategic Objective 2: *Strengthen the capacity of African business and community leaders to foster entrepreneurship and social philanthropy and to model transparency and accountability*

Under this new initiative, which ADF will develop over the next two years, the Foundation will mobilize the best local business people to promote entrepreneurship and social philanthropy and to serve as models of good business practices. Similarly, the Foundation will recruit the most respected community leaders where ADF operates to promote local initiate and to model transparency, accountability and integrity.

Strategic Objective 3: *Forge strategic partnerships with national and local governments, other donor agencies, and the private sector to fund programs that support enterprise and community development*

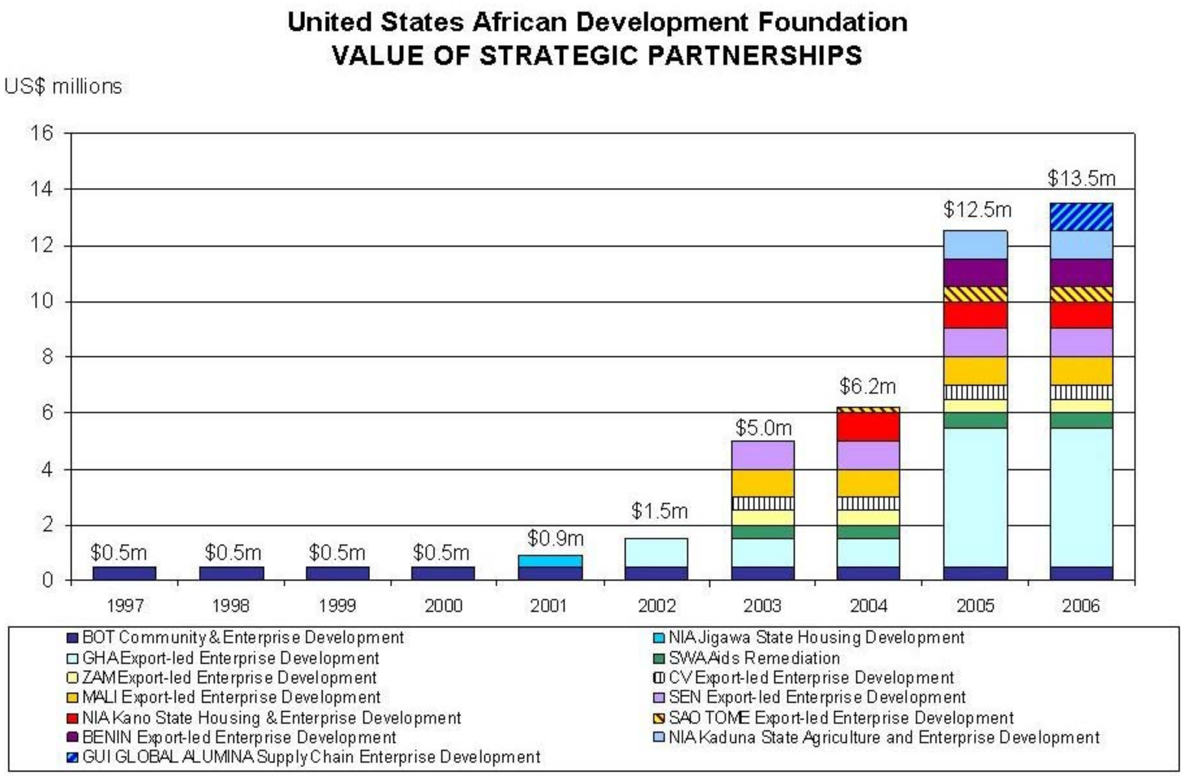
ADF is building innovative partnerships with African governments and international corporations that can serve as vital sources of capital and technology to expand the impact of the Foundation's program.

Because of the Foundation's high impact, unique approach, both African governments and large, socially responsible corporations are clamoring to partner with ADF and contribute hard cash to the Foundation to match appropriated funding. The Foundation already has signed Memoranda of Understanding with a dozen entities to contribute a total of $13.5 million. These include:

- Ghana – national government
- Nigeria – Kano State government and Kaduna State government
- Botswana – national government
- Swaziland – national AIDS commission
- Zambia – national government
- Cape Verde – national government

- Mali – national government
- Senegal – national government
- Sao Tome – national government
- Benin – national government
- Guinea – Global Alumina

The Foundation has received five additional partnership proposals totaling $5.0 million more, including Esso Exploration in Angola. The following chart provides a complete list of current partnerships and their funding levels, and the significant success ADF has had in attracting contributions.



In the context of individual projects, the Foundation also builds linkages between African enterprises and international business, which can serve as vital sources of complementary capital and technology for grassroots development, as well as markets for products. Some giants in the American private sector are seeing ADF's work as forging key links to markets. We are in active discussions with Target Corporation, Cargill and General Mills to develop African enterprises that will be able to produce to international standards and sell, at a fair price, to those companies.

In all these programs, the Foundation maintains and promotes its core values – transparency, accountability, sustainability, innovation, grassroots-based and African-owned investments – and ADF is wholly responsible for assuring accountability for funds, program implementation, and achievement of targeted results.

In FY 2007, ADF expects to attract $9.75 million in contributions through these strategic partnerships. These partnerships also provide excellent opportunities for ADF to influence more broadly national development strategies and program approaches.

Strategic Objective 4: *Promote and disseminate international and ADF best practices, lessons learned, and successful models for African-driven development*

Annual Performance Information – FY 2005

As indicated above, FY 2006 performance information will not be available until the end of November. Provided below is performance information for F 2005

Performance Tracking at ADF

ADF has collected performance results data on the active projects each year since 1999.[1] Due to changes in program priorities and decisions to focus on the most meaningful indicators that can be measured reliably many of the indicators used in the annual Assessment of Program Impact (API) have been modified over this period. The FY 2005 API indicators are similar to those used in FY 2004, except for a reduction in the number of indicators for microfinance projects and elimination of indicators for AIDS prevention and mitigation. In FY 2005, ADF decided to phase out support for these two program areas because many donors and NGOs are devoting substantially greater resources or more specialized expertise to them and ADF has a greater comparative advantage in direct support to enterprises at the grassroots level.

Most of ADF's new program obligations in a year do not lead to grant disbursements until the following year. Disbursements may continue for five or more years, but a large share of the total disbursements are typically released by the end of the third year of the project. Initial project impacts tend to follow disbursements with a lag time of six to twelve months. The impact tends to grow faster in subsequent years, reaching a maximum in the last year of the project. Consequently, the performance results reported in the reporting year are mainly an outgrowth of ADF disbursements over the previous 5 years, rather than the current year.

During FY 2005, ADF underwent its first Program Assessment Reporting Tool (PART) exercise. ADF worked closely with OMB to develop measurements that would best reflect ADF's performance against its strategic objectives. This intensive process allowed ADF to reconsider all its previous measures in order to develop a core set that would become the basis for future performance measurement. The exercise was very useful for ADF, and as a result of the hard work and collaborative effort involved, ADF received a PART score of "effective."

ADF developed 12 new program performance indicators for PART. Some of the PART indicators focus on the performance of the grantees' projects while others relate to the internal operations of the Foundation. ADF will report the PART indicators annually as part of the

[1] *Active projects* are grants that were in effect for at least one day during the reporting year and that have received. *disbursements* from the Foundation for activities other than ADF-required training in financial management and reporting.

Federal budget review process. Although ADF will continue collecting the API indicators as well because the information is useful in assessing the status of individual projects, country programs, and the overall portfolio, the Foundation's future performance targets in the budget documents will be based on the PART indicators.

The API indicators have only included the projects that were active during each year. To address sustainability and long-term impact, some of the PART indicators are also concerned with projects that were completed within the previous 3 years. To keep ADF's costs low for data collection on the completed projects and minimize the burden on former grantees, Country Representatives, and Partner Organizations, ADF decided not to collect data on the full set of API indicators for the completed projects. Information was only collected for the PART indicators for the completed projects and included whether the assisted enterprises or not-for-profit activities were still operating, cumulative sales revenues, the amounts and sources of any follow-on financing obtained, any awards or recognition received, and expansion and replication activities.

PART Indicators for Active and Completed Projects

In FY 2005, ADF developed 12 new organizational performance indicators for OMB's PART analysis, falling into 4 categories: 1) business growth, expansion, and sustainability; 2) resource mobilization, 3) information dissemination; and 4) operational efficiency. The definitions and calculations for these indicators are provided below. ADF was able to report results on 10 of these indicators this year. One of the new indicators is not relevant yet (Enterprise Trust Funds) since it pertains to an initiative that ADF plans to begin in a later year.

Table 11 summarizes the available data on the PART indicator achievements in the previous year and the reporting year against the targets for the reporting year. ADF's PART indicators were not established until mid-to-late FY 2005. At that time, ADF calculated the FY 2004 performance numbers from the information ADF had collected for the API and Annual Performance Report to Congress. ADF then set targets for FY 2005 based on the FY 2004 numbers, although the fiscal year was drawing to a close.

<u>Business Growth, Expansion, and Sustainability</u>

1. Revenue Growth: Cumulative increase in the sales of enterprise development projects over their extrapolated baseline level during the project period and the 3 years following the grant expiration date (annual).

Calculated as cumulative sales since project starting date minus (baseline sales x years since the project began) and obtained from grantee progress and financial reports.

2. Investment Multiplier: For every dollar disbursed to enterprise development projects that were active or have closed within the past 3 years, the cumulative increase in their gross revenues (sales) over the extrapolated baseline level during the project period and the 3 years following the grant expiration date (annual).

Calculated as Revenue Growth divided by cumulative disbursements of enterprise projects and obtained from grantee progress and financial reports.

3. Profitability: Percent of active enterprise development projects that have achieved a positive net income before income taxes, depreciation, and CRG contributions in the reporting year by the end of their third year or earlier (long-term).

Calculated as enterprise projects that were profitable and less than 3 years old + enterprise projects that were profitable and 3 years old or more) divided by (enterprise projects that were profitable and less than 3 years old + all enterprise projects that were 3 years old or more) and obtained from grantee progress and financial reports and obtained from grantee progress and financial reports.

4. Community Reinvestment: Percent of active enterprise development projects that are current in meeting their cumulative CRG pledges from the end of their third year and onward (long term).

Calculated as the number of enterprise projects that have made CRG contributions greater than or equal to their expected CRG contributions to date divided by the number of enterprise projects with CRGs applicable and provided by ADF's Management Division from records maintained by ADF's Partner Organizations.

5. Sustainability: Percent of completed enterprise development projects or social development projects that are still operating during the 3 years following expiration of the ADF grant (long term).

Calculated as the number of the number of projects that closed within the 3 years prior to the end of the reporting period that were still operating the ADF-funded business or activity divided by the total number of projects that closed within the past 3 years and obtained through a special annual data collection exercise.

Information Dissemination

6. Newsletter Subscribers: Total number of voluntary subscribers to ADF's e-newsletter (annual).

This information is currently recorded by the Webalizer software. ADF plans to switch to a competing product, Sawmill, in the near future.

7. Website Usage: Average number of page views of ADF's website per month (annual).

This information is currently recorded by the Webalizer software. ADF plans to switch to a competing product, Sawmill, in the near future.

Resource Mobilization

8. Partnership Contributions: Funds received from strategic partnerships during the year as a percentage of new ADF obligations for development projects (annual).

This information is provided by ADF's Finance Division from records of new program obligations and funding contributions received through strategic partnership agreements.

9. Follow-on Financing: Cumulative non-ADF loans, grants, or equity investments received by active and closed projects from the ADF grant start date through the 3 years following the expiration of the ADF grant (long term).

This information is obtained through a special annual data collection exercise conducted by ADF's Country Representatives with assistance from ADF's Partner Organizations.

10. Enterprise Trust Funds: Annual non-CRG, private sector investments or contributions for in-country enterprise trust funds (long term).

Not applicable for FY05. When relevant, will be obtained from trust fund records.

<u>Operational Efficiency</u>

11. Overhead Rate: ADF's non-program costs as a percentage of (USG appropriations + non-USG funding contributions received during the year) (annual).

Provided by ADF's Finance Division from the foundation's expenditures data recorded in the general ledger and the Federal appropriations and strategic partnership contributions received

12. Disbursement Efficiency: Median time required between the ADF Country Representative's receipt of a grant disbursement request from the partner organization and ADF transmittal of the funds (annual).

Provided by ADF's Management Division from the foundation's electronic database.

PART Indicator Trends and Achievements Versus Targets

PART Indicators	FY 2004	FY 2005 Reporting Year	FY 2005 Target	Percent of Target Achieved
Revenue growth of active and completed MSE and T&I projects w/baseline data	$20.5 million	$28.5 million	$23.0 million	144.9%
Investment multiplier of active and completed MSE and T&I	1.80	1.73	1.80	96.1%

projects w/baseline data				
Profitability of active MSE and T&I projects	65%	30.5%	65%	46.9%
Community reinvestment	No Data	No Data	No Target	Not applicable
Sustainability of completed projects	No Data	57%	No Target	Not applicable
E-newsletter subscribers	700	1,640	1,500	109.3%
Website usage	24,683	148,963	48,000	310.3%
Partnership contributions	29%	31%	28%	110.7%
Follow-on financing	No Data	$9.487 million	No Target	Not applicable
Enterprise trust funds	Not applicable	Not applicable	Not applicable	Not applicable
Overhead rate[1]	30%	23%	26%	113.0%
Disbursement efficiency[1]	45 days	33 days	45 days	136.4%

[1]Lower numbers represent better performance under these two indicators, while higher numbers are best for the other indicators.

ADF exceeded its internal targets for 6 of the 8 PART indicators with established targets for this reporting year. The number of hits on ADF's website greatly exceeded the target as a result of improvements in the website and interest generated by the electronic newsletter. ADF also made better than expected progress in increasing its disbursement efficiency, reducing its overhead rate, helping grantees achieve revenue growth, and attracting funding contributions from strategic partnerships. The investment multiplier indicator was slightly below the target and all of the variance can be attributed to projects that were completed within the past 3 years. ADF's current active projects met the investment multiplier target, reflecting the improvement that has taken place in the composition and performance of the portfolio.

The percent of projects that have achieved profitability was substantially lower than in the previous year and, consequently, lagged the target. While exchange rate changes may explain part of the decrease in the total net income gains of the portfolio in US dollars in FY 2005, it does not explain the decrease in the percentage of projects that were profitable in local currency terms. This year, petroleum prices rose sharply and increased many capital and operating costs across the board. Other changes in world commodity prices and domestic product prices at the micro level would need to be analyzed to explain the drop in the percentage of profitable projects. There were some serious country-specific macroeconomic problems, such as Guinea and Zimbabwe. There was a bad cycle of locusts in Mali and Niger affecting the agricultural economy. Differences in the weather across years (including droughts and floods) affect the profitability of many ADF-supported enterprises, directly because of their effects on enterprises that produce or process agricultural products and indirectly by reducing rural incomes.

By November 20, 2006, when all PART related information is reported to OMB, ADF will have a better understanding of whether the weaker than expected profitability measure in the reporting year was a one-time phenomenon or closer to the performance in a typical year than the previous year's results.

The completed projects have attracted $4.425 million in follow-on financing from non-ADF sources. Active projects are known to have received $2.597 million in follow-on financing, but this is based on very incomplete data (only 2 countries out of 14). The total for active and completed projects is $7.022 million.

Annual Performance Indicators

The table below shows FY 2005 performance against targets for ADF's traditional performance metrics. As noted above, beginning in FY 2006, ADF has decided to continuing measuring results for these criteria, but no longer set targets.

Since FY 2001, ADF's budget requests have included information on active project performance in prior years, as measured by the API indicators and tied the budget request to specific short-term and long-term performance targets. Some non-project specific targets, such as funding contributions from strategic partnerships, have been set independently of prior year performance. Most of the performance targets have been set taking into account the actual achievements in the most recent prior year available and the ratio of the budget or projected cumulative disbursements for active projects in the reporting year to those of the prior year.

This is a reasonable approach to setting aggregated portfolio targets, but it assumes that the composition of projects by strategic objective and country remains roughly the same from one year to the next. However, ADF is a grant-making organization that primarily responds to unsolicited proposals from African enterprises for African-led initiatives.[2] The Foundation funds the best of the submitted proposals without adhering to budget fixed allocations by country, type of project, location of the project, and the mix of ADF strategic objectives addressed. Because ADF responds to unsolicited proposals that cannot be predicted in advance, there are large differences in the mix of projects across years by strategic objective and country. As a result, the composition of the projects and their impact profile will vary across years, making comparisons of project achievements and targets somewhat problematic.

The table, below, summarizes the program results for the API indicators for active projects against ADF's targets for the reporting year. Cumulative numbers encompass the period from the starting date of the project through the end of the reporting year. All monetary values are presented in U.S. dollars using the exchange rates prevailing at the end of the reporting year. ADF exceeded all of its targets except for the very ambitious target for the amount of funding contributions received from strategic partnerships (83% of the target was achieved).

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[2] The small, pilot projects for AIDS prevention and mitigation that were funded in FY 2003 and 2003 were exceptions. These projects were identified through a solicited request for assistance.

Summary of Performance Against Targets (Cumulative figures for Active Projects With Significant Disbursements)[1]

Performance Indicator	FY 2005 Performance (Planned)	FY 2005 Performance (Actual)	Percent of Target Achieved
Enterprises assisted	83,300	108,341	130.1%
Owners and workers in assisted enterprises[2]	93,600	114,597	122.4%
Women as a percent of owners and workers[3]	Minimum of 50%	At least 64.9%	138.8%
Value of loans disbursed to MSEs	$10.870 million	$22.790 million	209.7%
Percent of loans disbursed to women[4]	Minimum of 50%	Indicator discontinued	-
Sales of grantee-operated enterprises[5]	$51.664 million	$54.836 million	106.1%
Export revenues	$7.342 million	$33.801 million	460.4%
People receiving HIV/AIDS prevention training[4]	224,100	Indicator discontinued	-
Women as a percent of those receiving HIV/AIDS training[4]	Minimum of 50%	Indicator discontinued	-
Countries with ADF support for building the capacity for nongovernmental partner organizations	No target	13	-
Number of strategic partnerships providing funding contributions	No target	6	-
Funding contributions received from strategic partnerships[6]	$4.200 million	$3.494 million	83.2%

[1]Cumulative refers to the period from the starting date of the ADF project through the end of the reporting year.
[2]To ensure that estimates are conservative, unless there was actual data on number of owners and workers per enterprise from surveys or grantee records, only one owner/worker was assumed per enterprise. The actual number of owners and workers is likely to be substantially higher.
[3]To ensure conservative, lower-bound estimates of women beneficiaries, it was assumed that all of the owners and workers were men when gender-disaggregated data were not available. The actual proportion of women among ADF's beneficiaries is higher than reported.
[4]These indicators were discontinued because ADF is phasing out support for projects in

microfinance and AIDS prevention and mitigation.
[5]The target included sales of products and services by enterprises and the gross revenues of credit providers. Since ADF decided to only report enterprise sales in FY 2005, the actual performance would have exceeded the target by more than the amount shown. The actual does not include the enterprise sales from the completed projects.
[6]The target pertained to funding contributions leveraged, which are often not received until the following year. The FY 2005 performance is based on funding contributions received, which is generally less than the amount leveraged since the funding contributions from strategic partnerships are growing. As a result, the percent of the target achieved is an underestimate.

LEONARD G. BIRNBAUM AND COMPANY, LLP

CERTIFIED PUBLIC ACCOUNTANTS
WASHINGTON OFFICE
6285 FRANCONIA ROAD
ALEXANDRIA, VA 22310-2510

703-922-7622
FAX: 703-922-8256

LESLIE A. LEIPER
LEONARD G. BIRNBAUM
DAVID SAKOFS
CAROL A. SCHNEIDER
DORA M. CLARKE

WASHINGTON, DC
SUMMIT, NEW JERSEY
REDWOOD CITY, CALIFORNIA

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and the President,
African Development Foundation:

We have audited the African Development Foundation's (ADF) Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, Statements of Budgetary Resources and Statements of Financing (Principal Financial Statements) as of, and for the years ended, September 30, 2006 and 2005; we have examined internal control over financial reporting in place as of September 30, 2006; and we have examined compliance with laws and regulations.

In our opinion, ADF's 2006 and 2005 Principal Financial Statements are presented fairly in all material respects.

We found no instances of material weakness in the internal controls over financial reporting or instances of noncompliance with selected provisions of applicable laws and regulations involving ADF's financial management system.

Each of these conclusions is discussed in more detail below. This report also discusses the scope of our work.

PRINCIPAL FINANCIAL STATEMENTS

In our opinion, ADF's 2006 and 2005 Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, Statements of Budgetary Resources, and Statements of Financing, including the notes thereto, present fairly, in all material respects, ADF's financial position as of September 30, 2006 and 2005, and the net cost of operations, the changes in net position, and use of budgetary resources, and the use of financing, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

INTERNAL CONTROL

We considered ADF's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Principal Financial Statements. We limited our internal control testing to those controls necessary to achieve the objectives described in the Office of Management and Budget's (OMB) Bulletin 06-03, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the following objectives are met:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over assets;

- funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and

- transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that the Office of Management and Budget (OMB), or ADF management have identified as being significant for which compliance can be objectively measured and evaluated.

- data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Our consideration of internal control would not necessarily disclose all matters of internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect ADF's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts, which would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operations that we considered to be material weaknesses as defined above.

Finally, with respect to internal control related to performance measures reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant controls relating to the existence and completeness assertions and determined whether those controls had been placed in operation as required by OMB Bulletin 06-03. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We noticed certain matters involving the internal control structure and its operation that we have reported to the ADF's management in a separate letter dated November 3, 2006.

COMPLIANCE WITH LAWS AND REGULATIONS

ADF's management is responsible for complying with laws and regulations applicable to ADF. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of ADF's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statements amounts, and certain other laws and regulations specified in OMB Bulletin 06-03, including the requirements referred to in FFMIA. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to ADF. The objective of our audit of the Principal Financial Statements, including our tests of compliance with selected provisions of applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements or violations of prohibitions in statutes and regulations, which cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements or that sensitivity warrants disclosure thereof.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* and OMB-Bulletin 06-03.

Under FFMIA, we are required to report whether the ADF's financial management systems substantially comply with the federal financial management system requirements, applicable accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements. The results of our tests disclosed no instances where the ADF's financial management systems did not substantially comply with the Federal financial management system requirements, applicable Federal accounting standards, or the United States Government Standard General Ledger at the transaction level.

We noted certain instances of noncompliance that we have reported to the ADF's management in a separate letter dated November 3, 2006**.**

RESPONSIBILITIES AND METHODOLOGY

ADF management has the responsibility for:

- preparing the Principal Financial Statements and other accompanying information in conformity with accounting principles generally accepted in the United States of America;

- establishing and maintaining effective internal control; and

- complying with applicable laws and regulations.

Our responsibility is to express an opinion on these Principal Financial Statements based on our audit. Auditing standards generally accepted in the United States of America require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Financial Statements are free of material misrepresentation and presented fairly in accordance with accounting principles generally accepted in the United States of America. We considered ADF's internal control for the purpose of expressing our opinion on the Principal Financial Statements referred to above and not to provide an opinion on internal control. We are also responsible for testing compliance with selected provisions of applicable laws and regulations that may materially affect the financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the Principal Financial Statements;

- assessed the accounting principles used and significant estimates made by management;

- evaluated the overall presentation of the Principal Financial Statements;

- obtained an understanding of the internal controls over financial reporting by obtaining an understanding of the agency's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls;

- obtained an understanding of the internal controls relevant to performance measures included in Management's Discussion and Analysis, including obtaining an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether they had been placed in operations;

- obtained an understanding of the process by which the agency identifies and evaluates weaknesses required to be reported under FMFIA and related agency implementing procedures;

- tested compliance with selected provisions of laws and regulations that may have a direct and material affect on financial statements;

- obtained written representations from management; and

- performed other procedures, as we considered necessary in the circumstances.

Our audits were conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin 06-03. We believe that our audits provide a reasonable basis for our opinion.

The Management's Discussion and Analysis is not a required part of the Principal Financial Statements, but are supplementary information required by OMB Circular A-136, *Financial Reporting Requirements*, and the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit he information and express no opinion on it.

This report is intended for the information of the Inspector General of U.S. Agency for International Development and management of the African Development Foundation. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

/s/

Leonard G. Birnbaum and Company, LLP

Alexandria, Virginia
November 3, 2006

African Development Foundation
BALANCE SHEETS
As of September 30, 2006 and 2005

	FY 2006	FY2005
ASSETS		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$25,498,947	$23,953,010
Total Intragovernmental	25,498,947	23,953,010
Cash and other monetary assets (Note 3)	4,416,145	3,851,678
General property, plant and equipment – Net (Note 5)	769,066	436,535
Advances and Prepayments (Note 4)	3,774,857	3,847,050
TOTAL ASSETS	$34,459,015	$32,088,273
LIABILITIES		
Accounts Payable (Note 6)	$ 502,311	$ 284,769
Accrued Payroll (Note 6)	122,460	107,869
Accrued Leave (Note 6)	211,182	193,158
TOTAL LIABILITIES	$ 835,953	$ 585,796
NET POSITION		
Unexpended Appropriations	27,055,611	27,204,690
Cumulative Results of Operations	6,567,451	4,297,787
TOTAL NET POSITION	$33,623,062	$31,502,477
TOTAL LIABILITIES AND NET POSITION	$34,459,015	$32,088,273

The accompanying notes are an integral part of these statements.

African Development Foundation
STATEMENTS OF NET COST
For the Years Ended September 30, 2006 and 2005

	FY 2006	FY 2005
PROGRAM COSTS		
Program expenses	$12,930,948	$12,074,695
Operating Expenses – Public	9,018,800	7,439,268
Operating Expenses – Intragovernmental	188,159	140,630
TOTAL PROGRAM COSTS	22,137,907	19,654,593
NET PROGRAM COSTS	22,137,907	19,654,593
NET COST OF OPERATIONS	$22,137,907	$19,654,593

The accompanying notes are an integral part of these statements.

African Development Foundation
STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended September 30, 2006 and 2005

	FY 2006		FY 2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	$ 4,297,787	$27,204,690	$1,298,534	$27,379,686
Budgetary Financing Sources				
Appropriations Received		23,000,000		19,000,000
Rescission & Cancelled Resources		(1,330,702)		(156,189)
Appropriations Used	21,818,377	(21,818,377)	19,018,807	(19,018,807)
Nonexchange Revenue	2,401,035		3,494,409	
Other Financial Services				
Imputed Financing	188,159		140,630	
Total Financing Sources	24,407,571	(149,079)	22,653,846	(174,996)
Net Cost of Operations	(22,137,907)		(19,654,593)	
Net Change	2,269,664	(149,079)	2,999,253	(174,996)
Ending Balances	$ 6,567,451	$ 27,055,611	$ 4,297,787	$27,204,690

The accompanying notes are an integral part of these statements.

African Development Foundation
COMBINED STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30, 2006 and 2005

	FY 2006	FY2005
BUDGETARY RESOURCES		
Budget Authority – Appropriation	$25,401,035	$22,494,462
Unobligated Balance Brought Forward, October 1	5,800,270	5,669,528
Adjustments:		
Net Results of Foreign Currency Adjustment PY Obligations	214,367	2,595,184
Rescission Current Year	(230,000)	(152,000)
Permanently not available	(1,100,702)	(4,189)
TOTAL BUDGETARY RESOURCES	$30,084,970	$30,602,985
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred – Current Period	23,441,998	24,803,215
Unobligated balances – available (Note 3)	4,104,690	4,645,506
Unobligated balances – unavailable (Note 3)	2,538,282	1,154,264
TOTAL STATUS OF BUDGETARY RESOURCES	$30,084,970	$30,602,985
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated balance, Net – Beginning of Period	22,004,418	20,525,209
Obligated balance, Net – End of Period		
Accounts Payable	624,771	392,638
Undelivered Orders	22,647,349	21,611,780
Outlays:		
Disbursements	21,959,928	20,728,822
Collections	-	(500)
Net Outlays	$21,959,928	$20,728,322

The accompanying notes are an integral part of these statements.

African Development Foundation
STATEMENTS OF FINANCING
For the Years Ended September 30, 2006 and 2005

	FY 2006	FY2005
RESOURCES USED TO FINANCE ACTIVITIES		
Obligations Incurred	$23,441,998	$24,803,215
Less: Spending Authority from Offsetting Collections & Adjustments	(214,367)	(2,595,184)
Net Obligations	23,227,631	22,208,031
Financing Imputed for Cost Subsidies	188,159	140,630
Net Other Resources Used to Finance Activities	188,159	140,630
Total Resources Used to Finance Activities	23,415,790	22,348,661
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS		
Change in budgetary resources not yet provided (Increase)	(964,011)	(2,740,128)
Resources that finance the acquisition of assets	(524,556)	(72,630)
Total resources that do not fund net costs	(1,488,567)	(2,812,758)
Total Resources Used to Finance Net Cost of Operations	21,927,223	19,535,903
Costs that will not Require Resources in this Period:		
Increase (decrease) in Accrued Annual Leave Liability	18,024	(14,151)
Total Costs that will Not Require Resources in this Period	18,024	(14,151)
Components not Requiring Resources	192,660	132,841
Total costs that do not require resources	192,660	132,841
NET COST OF OPERATIONS	$22,137,907	$19,654,593

The accompanying notes are an integral part of these statements.

African Development Foundation
Notes to the Financial Statements
As of September 30, 2006

Note 1. Organization

The African Development Foundation ("ADF" or "the Foundation") is a government-owned corporation established by Congress under the African Development Foundation Act in 1980 and began operations in 1984. The Foundation is the principal agency of the U.S. Government that supports community-based, self-help initiatives that alleviate poverty and promote sustainable economic and social development in Africa at the grassroots level. The Foundation's headquarters are in Washington, D.C. ADF maintains partnerships with local organizations, staffed with African professionals, in each of the countries in which it operates. Over the past 21 years, the Foundation has funded more than 1600 projects in 34 African countries.

Note 2. Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis to report the financial position and results of operation in accordance with the concepts and standards contained in the Statements of Federal Financial Accounting Standards, as required by the Chief Financial Officers Act of 1990. These statements have been prepared from the books and records of the Foundation in accordance with the form and content for federal financial statements specified in the Office of Management and Budget (OMB) in *OMB Circular No A-136, Financial Reporting Requirements,* as amended, and the Foundation's accounting policies, which are summarized in this note.

B. Basis of Accounting

Transactions are recorded on an accrual basis. Grants are recorded when obligated and expenses are recognized when the funds are expended, without regard to receipt or payment of cash. The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of grants and expenses during the reporting period. Actual results will invariably differ from those estimates.

C. Fund Balances with Treasury and Cash

The Foundation maintains the majority of its funds in the U.S. Treasury. These are amounts for which the Foundation is authorized to make expenditures and pay liabilities. In addition, commercial, noninterest bearing accounts (in local currencies) are maintained with Barclays Bank of Botswana, Citibank Nigeria, and Banco Comercial do Atlantico in Cape Verde, Standard Chartered Bank in Ghana, Ecobank in Mali, Citibank and Zenith Bank in Nigeria, First National Bank of Swaziland in Swaziland, and Standard Chartered Bank in Zambia to process grant funds for those countries. Governments with whom ADF has entered Strategic Partnerships deposit donations into these accounts. In general, grants are funds equally with appropriated funds and donated funds. ADF controls all disbursements from these accounts.

D. Foreign Currencies

The Foundation awards grants to private organizations in Africa. Most of the grants are denominated in local currencies to facilitate accounting by the recipient organizations. Depending on the nature of the transaction, foreign currencies are translated into dollars at the actual exchange rate received by the Foundation when the transaction is made or at the prevailing exchange rate at the beginning of the month in which the transaction occurred. The value of obligations incurred by the Foundation in foreign currencies varies from time to time depending on the current exchange rate. The Foundation adjusts the value of its obligations at the end of each quarter during the year to reflect the prevailing exchange rates. Downward adjustments to prior year obligations based on favorable foreign currency exchange rates will be made available for obligation if the adjustment occurs within the Foundation's authorized two year funding period. Upward adjustment to prior year obligations based on unfavorable foreign currency exchange rate with the U.S. dollar will be made from funds made available for upward adjustments, if any, or from currently available funds.

E. Grant Accounting

The Foundation disburses funds in advance to grantees to cover their projected expenses over a three-month period. Grantees report to the Foundation periodically on the actual utilization of these funds. For purposes of these financial statements, the Foundation treats disbursements to grantees as advances. The advance is reduced when the grantee reports expenditures. The total grant advance is the total amount disbursed to the grantee less the total expended for open (nonexpired) grants as of the reporting date. In order to ensure timeliness in reporting grantee expenditures, the Foundation will use estimates to complete to calculate the last quarter's grantee expenditures based on historical expenditure trends since 1996 and disbursement activity funding that quarter's activity. The actual expenditures adjustments will be reported in the following quarter's financial statements. Once a grant has closed (expired or cancelled) any excess disbursement is reclassified as an Accounts Receivable.

F. Travel Advances

Advances are given to ADF employees for official travel. Travel advances are recorded as expenses upon receipt of employee travel vouchers.

G. Property, Plant and Equipment, Net

The space in which the Foundation operates is leased by the Foundation through a multi–year lease. Equipment is depreciated using the straight–line method over useful lives, which is estimated at five years. Equipment with an acquisition cost of less than $5,000 or less than two years of life is expensed when purchased.

H. Accounts Payable

Accounts payable represent amounts owed to nonfederal entities, primarily commercial vendors, for goods and services received by ADF.

I. Contingencies

The Foundation is a party in various administrative legal actions and claims brought by or against it. According to the Foundation's legal counsel, the likelihood of unfavorable outcomes for all these legal actions and claims is remote. In the opinion of the Foundation's management, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or results of operations of the Foundation.

J. Annual, Sick, and Other Leave

Annual, sick and other leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the Foundation calculates the value of the accrued annual leave at the end of the year based on current pay rates. Funding for payment of accrued annual leave at the end of the year will be taken from future financing sources. Sick leave and other types of nonvested leave are expensed as taken.

K. Retirement Plan

The Foundation's employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The Foundation makes statutory contributions to the Office of Personnel Management for employees enrolled in each plan. The Foundation does not report accumulated assets, plan benefits or unfunded liabilities, if any, attributable to its employees. The Office of Personnel Management reports such amounts.

L. Trust Fund

The Foundation maintains a Trust Fund with the U.S. Treasury in accordance with its gift authority.

Note 3. Fund Balance with Treasury

A. Fund Balances and Funds Held Outside Treasury

ADF's Fund Balance with Treasury and Funds Held Outside Treasury as of September 30, 2006 and 2005 are summarized below:

	FY 2006	FY 2005
Appropriated Funds	$ 25,467,393	$ 23,936,136
Trust Fund	31,554	16,874
Total Fund Balance with Treasury	$ 25,498,947	$ 23,953,010
Barclays Bank of Botswana	1,104,267	1,066,426
Standard Chartered Ghana	1,100,275	1,891,050
Citibank Nigeria	39,013	39,013
First National Bank Swaziland	281,088	193,407
Zenith Bank Nigeria	226,984	151,515
Standard Chartered Zambia	(37,431)	152,869
EcoBank Senegal	402,017	-
EcoBank Mali	987,496	-
Cape Verde	312,436	357,398
Total Funds Held Outside Treasury	$ 4,416,145	$ 3,851,678
Total	$ 29,915,092	$ 27,804,688

B. Status of Fund Balance With and Outside Treasury

	FY 2006	FY 2005
Unobligated Balance		
Available	$ 4,104,690	4,645,506
Unavailable	2,538,282	1,154,264
Obligated Balance not yet Disbursed	$ 23,272,120	$ 22,004,918
Total	$ 29,915,092	$ 27,804,688

Note 4. Advances

ADF's advances as of September 30, 2006 and 2005 are summarized below:

	FY 2006	FY2005
Grants	$ 3,319,149	$ 3,471,739
Travel	230,821	42,323
Prepayments	224,887	332,988
Total	$ 3,774,857	$ 3,847,050

Note 5. Property, Plant and Equipment, Net

Equipment is capitalized at cost if the initial unit acquisition cost is $5,000 or more and service life is two years or more. Equipment with an acquisition cost of less than $5,000 or less than two years of life is expensed when purchased.

ADF's property, plant and equipment as of September 30, 2006 and 2005

	FY 2006	FY 2005
Equipment, at cost	$ 1,818,078	$ 1,365,114
Accumulated Depreciation	(1,049,012)	(928,579)
Equipment, net	$ 769,066	$ 436,535

Note 6. Accounts Payable and Other Liabilities

Accounts payable represent amounts owed to nonfederal entities, primarily commercial vendors for goods and services received by ADF, and accrued employee payroll and annual leave.

	FY 2006	FY 2005
Commercial vendors	$ 502,311	$ 284,769
Accrued employee payroll and leave	333,642	301,027
Total	$ 835,953	$ 585,796

Note 7. Leases

The space in which the Foundation Headquarters operates is leased by the Foundation through a multi-year lease until April 30, 2008. The total amount of funding commitment is detailed in Table 1.

ADF also enters into year-to-year leases in the countries with established Resident Representative offices.

TABLE 1 – ADF Headquarters'

Space Lease – Total Future Payment Due

Fiscal Year	Dates	Amount
Year 1	October 1, 2006 – September 30, 2007	$391,842
Year 2	October 1, 2007 – April 30, 2008	$232,874
TOTAL		$624,716

Note 8. Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the United States Government.

The 2008 Budget of the United States Government, with the Actual Column completed for fiscal year 2006, has not yet been published as of the date of these financial statements. The Budget is currently expected to be published and delivered to the Congress in February 2007. The 2007 Budget of the United States Government, with the Actual Column completed for fiscal year 2005, has been reconciled.

Appendix I

Management Comments

November 15, 2006
Mr. Donald Gambatesa
Inspector General for Audit
Office of the Inspector General, U.S.A.I.D.
1300 Pennsylvania Avenue
Washington, D.C. 20523-8100

Re: Audit Report of the 2006 Financial Statement

Dear Mr. Gambatesa:

We have received the audit report supplied by Leonard G. Birnbaum and Company, including the opinion on the African Development Foundation's (ADF) fiscal years 2005 and 2006 comparative financial statements, internal controls status, and compliance with applicable laws and regulations. We are pleased to note that all five comparative financial statements (Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing) have continued to receive unqualified opinions. Thank you and your team as well as Birnbaum and Company for working closely with us during the audit process.

We at the African Development Foundation recognize the importance of accountability and public disclosure and our goal is to achieve excellence in our financial management systems. We are committed to resolving the issues identified in your report and have dedicated the staff and resources to ensure our systems are in full compliance. We look forward to working with you and your staff on the 2007 audit. Any questions may be addressed to Martha C. Edmondson, Chief Financial Officer at ADF or to me.

Sincerely,

/s/

Rodney J. MacAlister
President

1400 Eye Street, N.W. · Tenth Floor · Washington, D.C. 20005 · (202) 673-3916 · fax: (202) 673-3810 · email: info@adf.gov

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Ave, NW
Washington, DC 20523
Tel: (202) 712-1150
Fax: (202) 216-3047
www.usaid.gov/oig