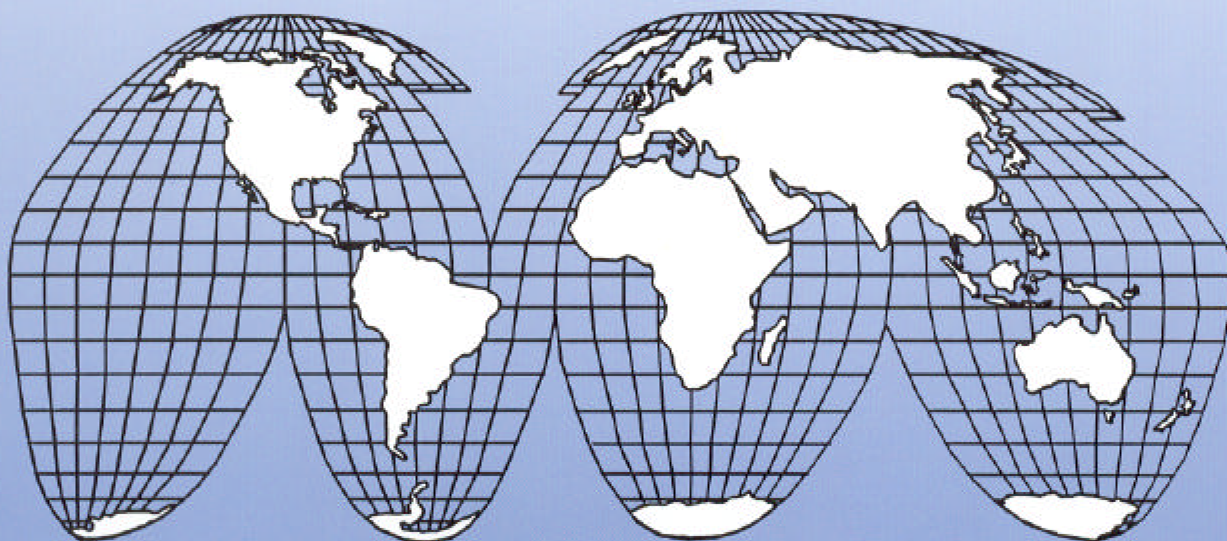
USAID

OFFICE OF INSPECTOR GENERAL

Audit of Awarding and Monitoring of Grants by the African Development Foundation

Audit Report Number 9-ADF-03-005-P

February 28, 2003



Washington, DC

February 28, 2003

MEMORANDUM

FOR: ADF President, Nathaniel Fields

FROM: IG/A/PA, Dianne L. Rawl /s/

SUBJECT: Audit of the Awarding and Monitoring of Grants by the African Development Foundation (Report No. 9-ADF-03-005-P)

This memorandum is our final report on the subject audit. In finalizing the report, we considered your comments on our draft report and have included this response as Appendix II.

This report includes eleven procedural recommendations. In your written comments, you concurred with these recommendations and identified planned or completed actions to address our concerns. Consequently, we consider all recommendations to have received a management decision. The Foundation's audit committee must determine final action on these recommendations, and we ask that we be notified of the audit committee's actions.

I want to express my sincere appreciation for the cooperation and courtesies extended to my staff during the audit.

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Summary of Results

The African Development Foundation (ADF) did not always evaluate and select grant proposals for funding in accordance with its internal policies and procedures. For 10 of the 18 projects reviewed, ADF did not have clear economic justification for proposed enterprises or used unsupported data that may have overstated their potential profitability. As a result, some of the 10 projects may prove to be unsustainable after the completion of their grant periods. In addition, although ADF policy required that a comprehensive environmental assessment be conducted before projects were approved, we identified three projects that did not meet this standard. When projects do not receive a full environmental assessment, there is an increased risk that the projects could contribute to environmental problems. (See pages 9 through 15.)

During fiscal year 2001, ADF did not implement an effective system to monitor its projects and obtain project results. ADF records indicated that the Foundation's Country Liaison Offices (CLO) staff did not complete the recommended number of monitoring visits to each project. Also, contrary to ADF procedures, monitoring reports often did not indicate the progress grantees had made toward achieving each grant objective, and usually did not document steps needed to resolve issues that may be impeding project success. In addition, progress reports submitted by grantees did not always include accurate and useful information about cumulative progress against the baseline, annual or end-of-project objectives. ADF officials noted that monitoring activities had been hampered by the Foundation's reorganization efforts during fiscal year 2001. As a result, during the period covered by this audit, the Foundation could not reliably determine if its programs were meeting objectives and would become sustainable. (See pages 15 through 24.)

ADF did not implement an effective system to audit funds provided to grantees. While ADF selected local accounting firms in accordance with Foundation policy, the firms did not always incorporate all required work steps in their programs and did not perform, or did not properly document, several important accountability checks. Contrary to ADF policy, the ADF Internal Auditor did not conduct audits of the funds provided to CLOs in accordance with Government Auditing Standards or as often as required by ADF policy. Furthermore, ADF did not have a process that ensured that all significant audit recommendations were tracked and implemented. As a result, the audits provided limited assurance that grant funds were being used for intended purposes. (See pages 24 through 34.)

In it response to our draft report, ADF concurred with our recommendations and described the actions the Foundation has planned or undertaken to address our concerns. When fully implemented, these actions should significantly improve the Foundation's selection, monitoring and audit processes. (See page 35.)

Background

The African Development Foundation (ADF) is a U.S. Government corporation established by Congress in 1980. ADF is authorized to award grants, loans, and loan guarantees to African private or public groups, associations, or other entities engaged in peaceful activities. ADF's appropriation for fiscal year 2002 was $16.5 million. Over the last 18 years, ADF has funded over 1300 activities in 34 African countries.

One of ADF's primary goals is to advance broad-based, sustainable development and the empowerment of the poor in Africa. ADF pursues this objective, in part, by providing (1) grants to small enterprises that can generate income and employment, and (2) grants to micro-finance institutions to increase the flow of investment capital to the poor.

During the period covered by the audit, ADF maintained a local office, staffed with African professionals, in each of the countries in which it operated. These offices, called Country Liaison Offices (CLOs), developed new grants and monitored funded projects. ADF has since replaced its CLOs with new organizations (called Partners) that provide technical assistance to grantees, including assistance with project monitoring. Although our review examined CLO activities during fiscal year 2001, our findings and recommendations are also valid for the new Partner organizations.

In November 1999, Public Law 106-113 amended the responsibilities of the USAID Inspector General, under Section 8A(a) of the Inspector General Act of 1978, to include audit responsibility for ADF. This audit represents the first audit of ADF field activities, completed as part a comprehensive strategy by the Office of the Inspector General (OIG) to maintain effective oversight of ADF operations.

Audit Objectives

We designed the audit to answer the following questions:

- **Did the African Development Foundation award grants in accordance with Foundation policies and procedures?**
- **Did the African Development Foundation implement a system to monitor grantee projects and obtain project results?**
- **Did the African Development Foundation implement a system to audit funds provided to grantees?**

This audit was performed as part of the OIG's fiscal year 2002 audit plan. The audit covered 18 projects in four of the countries where ADF had active projects—Benin, Senegal, Uganda, and Tanzania. See Appendix I for more information about the scope and methodology for this audit.

Audit Findings

Did the African Development Foundation award grants in accordance with Foundation policies and procedures?

The African Development Foundation (ADF) did not always evaluate and select grant proposals for funding in accordance with its internal policies and procedures. ADF policies and procedures required that the Foundation use sound analyses, including analyses of the economic environment (e.g., price, market demand, competition, and group production capabilities), and cash flow projections before approving proposed enterprise projects. This guidance, however, was not consistently applied. For 10 of the 18 projects reviewed, ADF did not have clearly stated economic justifications or used unsupported data that may have overstated the potential profitability and sustainability of proposed enterprise projects.

According to ADF officials, most of the 10 projects had been developed and reviewed by ADF staff members who did not have sufficient training in economics and marketing. Furthermore, at that time, the Foundation was focused more on social impact than on business concerns. Because of the inadequate review process, some of the 10 projects may be unsustainable when the ADF grant ends.

In addition, although ADF policy required that a comprehensive environmental assessment be conducted before projects were approved, 3 of the 18 projects reviewed did not meet this standard. ADF officials attributed this to staff oversight during document preparation. When environmental analyses are not completed and evaluated, there is risk that the affected projects could create environmental hazards.

ADF Needs to Validate Economic Assumptions Prior to Grant Approval

ADF's grant approval process generally started with proposals submitted by grant applicants to a Country Liaison Office (CLO).[1] Once a group submitted a proposal, the CLO verified background information about its history and capabilities. In addition, the CLO performed an initial assessment of each new proposal to determine its viability based on economic, technical, environmental and managerial factors.

[1] According to ADF policy, groups requesting funds were required to be legal entities with the rudimentary skills to undertake the proposed project, unless the project was a logical outgrowth of the group's current or past activities.

ADF's Regional Managers evaluated project proposals recommended by the CLO and determined if the information provided was adequate and if the proposed projects appeared financially sound. They also ensured that (1) the findings of ADF-required analyses were valid, (2) sound financial analyses and projections had been used, (3) the economic environment (market demand, competition, and group production capabilities) had been appropriately analyzed, and (4) reasonable economic assumptions were clearly stated.

When the Foundation's Washington–based country team (Regional Director and Regional Managers) judged that a proposed project met ADF's basic selection criteria, the project was then reviewed and evaluated by the Project Discussion Group (PDG), composed of the Foundation's senior managers. PDG concerns were to be included in a memo returned to the country team and the CLO. The Regional Director was responsible for determining that all PDG issues had been appropriately addressed before projects were recommended for funding.

For 10 of the 18 projects reviewed, ADF did not ensure that reasonable economic assumptions were clearly stated in the grant proposal documents, or it used unsupported data that may have overestimated the potential profitability and sustainability of the proposed enterprises. In particular, project proposal documents did not always contain adequate support for economic assumptions concerning (1) the demand for products being offered by the small enterprises, (2) the proposed sales price of products, and (3) the potential impact of competition.

The following section describes, for the 10 projects mentioned above, examples of (1) unresolved discrepancies that surfaced during the approval process, and (2) unsupported assumptions that were the basis for favorable predictions of project success.

Benin 1136, Brick and Tile Project - In August 1998, ADF approved a five-year grant of $54,051 to the Local Construction Materials Promotion Group, an 18-person cooperative specializing in the production of earth bricks and concrete roofing tiles. These funds were intended to be used to establish a production facility for the manufacture of brick and tiles; purchase an 8-ton truck for the transport of materials and finished products; provide working capital for such expenses as raw materials, advertising and insurance; and provide members with training in tile manufacturing, bookkeeping, and management.

The objectives included in the grant agreement with ADF were as follows: (1) increase the group's technical, marketing, financial and managerial skills; (2) expand brick and tile production; and (3) increase the revenue and profits of the enterprise. Thirty-five percent of the profit would be returned to the members, with the rest spent on legal reserves (10 percent), reinvestment (50 percent), and social activities (5 percent).

Several ADF project selection documents predicted that the brick and tile enterprise would be profitable and sustainable. One document stated that the demand for bricks exceeded the group's capacity to produce and deliver them and that roof tiles were attractive to people who could afford the higher initial cost of installation. Revenue from the enterprise was expected to nearly triple during the five years of the grant.

However, a pre-award feasibility study commissioned by the CLO did not support ADF's conclusion. The study stated that only about 20 percent of Benin's population could afford houses made of bricks and roofing tiles and houses made with roofing tiles accounted for less than one percent of all homes. The study also estimated (without providing any supporting documentation) that the grantee's facility would produce and sell 180,000 bricks and 67,500 roofing tiles per year by the project's second year. The study did not explain why local competitors were not meeting the unmet demand for bricks, although it noted that the ten local brick makers had a capacity of 4,000 bricks per day (over 1 million bricks per year based on a 5-day work week). ADF's review of the project did not address these concerns about demand or competition.

Photograph of empty tile-curing basins at ADF's Brick and Tile project in Benin. The economic analysis predicted that there would be times when the project would not be able to produce at full capacity because the curing basins would be full.

Three years into the 5-year project, the group had completed less than 3 percent of the anticipated life-of-project brick production and only 24 percent of the tile production. Although the project was expected to earn significant profits for the group, it operating at a loss and more than half of the group's members left the project to work elsewhere.

Senegal 1275, Ceramics Project - In September 1999, ADF signed a grant agreement with the Workshop for Ceramic Production and Promotion. The ADF grant, totaling $59,258, funded the upgrade of equipment in an effort to improve the quality and efficiency of pottery and ceramics production. The specific objectives as outlined in the grant agreement were to (1) improve members' business management and marketing skills, (2) expand production of ceramic art, (3) increase members' earnings, (4) generate funds for equipment replacement and building repair, (5) generate increasing profits, and (6) provide ceramic stove elements to 250 customers.

To determine if the project would be sustainable, ADF completed a cash flow analysis using projected sales of ceramic art and stove elements. According to ADF documents, the assumed prices for these products were calculated to take into account production costs plus a reasonable profit margin for the group. However, the actual selling price for these elements in Senegal was not considered. After the first year, the expected sales were assumed to be equal to 100 percent of the project's monthly production capacity, and ADF expected the group's profits to increase by over 1600 percent during the 5-year life of the project. Support for these assumptions was not stated.

After two years of operation, production remained far below targets. According to the grantee's September 2001 trimester performance report, production had reached only about three percent of expectations and the business was operating at a loss. Members had not received any of the planned earnings distributions. Funds set aside for equipment replacement and repair were less than three percent of the targeted amount.

Uganda 1293, Garbage Recycling Project - In September 1999, ADF signed a 4-year grant agreement for $235,088 to fund a garbage recycling project in a district about ten miles from Uganda's capital city of Kampala. The project involved collecting garbage from both commercial and residential areas, recycling any decomposable garbage, and packaging and selling the compost to farmers as organic fertilizer. ADF funds supported the purchase of machinery and equipment and infrastructure construction. ADF funds also supported operational costs and training.

According to ADF pre-award review documents, the proposed project appeared to be both sustainable and profitable and held potential for replication. However, the economic and marketing analysis submitted with the proposal did not identify the price that customers would be willing to pay for the organic fertilizer. Instead, the analysis stated that the group's fertilizer should be priced to cover the group's operational costs and make sufficient profit to allow expansion of the enterprise. In addition, the analysis showed that 650 metric tons of fertilizer could be sold each month, without explaining the basis for this estimate.

As part of the proposal review, the ADF Regional Manager asked where potential customers currently obtain their fertilizer. In response, the CLO referred to the same unsupported data that had been originally submitted. In the end, ADF's economic analysis stated only that indications of high demand were based on (1) the comments of an unspecified number of customers who stated that they would buy more fertilizer, and (2) the assertion that farmers around the project had shown interest in this fertilizer. The group's production target was set at 272 metric tons per month. This estimate seemed optimistic in comparison to the group's total pre-grant production and sales of 400 metric tons in the previous two years, only about 17 metric tons per month.

During the last trimester ending September 30, 2001, the group sold less than three percent of the expected amount of fertilizer. Group representatives cited the lack of demand as the major reason for the slow sales. After three years of operation, the project had not become profitable.

Although well-supported economic analyses do not guarantee that an enterprise will be successful, such studies (1) were required by ADF policy, and (2) help ensure that only projects with the best potential are funded. Realistic market analysis are critical but challenging, as they must estimate the unmet demand for specific products giving adequate consideration to variables, including price assumptions, reactions by competitors, and general economic conditions for a given population. For several of the projects ADF funded, continued demand for the grantee's products was a fundamental, but often unsupported, predictor of project success.

ADF officials stated that many of the projects reviewed for this audit had been approved during a period when the Foundation focused more on potential social impact than on generating income. The officials stated that after February 1999, ADF personnel received training to improve their ability to prepare and review financial analyses.

However, as demonstrated by the ceramics and garbage recycling projects, some projects approved after February 1999 lacked adequate support demonstrating that products could be sold at a price to cover costs. Furthermore, it was assumed that sufficient product demand could be developed to ensure project sustainability.

ADF officials also stated that the Foundation is developing new procedures that will ensure that the composition of the PDG changes as needed to ensure that personnel with appropriate skills and knowledge review each project. According to ADF, PDG recommendations will be comprehensive in identifying all relevant issues critical to funding decisions. However, ADF should ensure that trained staff participate in project selection and development processes.

Recommendation No. 1: We recommend that the African Development Foundation develop procedures that require that staff members who have been trained to evaluate the economic assumptions of project proposals participate in project development and reviews.

ADF Needs to Ensure That Environmental Reviews Are Completed

ADF policy stated that the Foundation would not fund projects that contemplated the use or production of material or substances known to be hazardous to human health. According to ADF's selection procedures, the CLO or a technical assistance provider should determine, among other things, (1) the types of chemicals being proposed for use, (2) waste products to be generated and means of their disposal, (3) applicable government regulations, and (4) strategies to mitigate degradation to the environment. The policy further provided that environmental issues should be incorporated into the project documents reviewed by the PDG.

For three of the micro-enterprise projects reviewed, ADF did not fully evaluate potential negative environmental consequences before approving the grants. When environmental analyses are not completed and evaluated, there is risk that the affected projects could create environmental hazards. The problems identified are explained below.

Benin 1122, Print Shop - In July 1998, ADF provided funding to PRIM'ETIC, a cooperative enterprise specializing in printing and graphic art design. PRIM'ETIC made greeting cards, flyers, invitations and other printed materials. ADF provided $132,627 to construct and equip a printing workshop, including the purchase of presses, computers, and a delivery vehicle.

According to the environmental analysis of the project prepared by a consultant selected by the CLO, "printing and graphic art activities do not have a negative impact on the environment. They produce no effect that can cause environmental degradation." However, when screening the project for environmental impact, an ADF official noted that solvents used to clean printing presses are considered hazardous waste and not only degrade the environment but also are frequently toxic.

Another official noted that efforts should be made to make the project more environmentally friendly by recycling printing wastes. Therefore, the Regional Manager recommended that "adequate procedures for the disposal of wastes" should be included in the project description. Despite the recommendation, a summary of the environmental factors was not included in the final project paper, and the grant agreement did not describe any specific disposal procedures for hazardous inks, solvents and other materials. In March 2002, auditors found such materials stored in open containers at the project site. Grantee representatives acknowledged that these substances could be harmful but stated that there were no special procedures for using, disposing or recycling these materials.

Benin 1092, Cold Storage and Senegal 1098, Fish Marketing - In both projects, approved in September 1997, there were environmental issues related to cold storage and refrigerants that were not addressed in the CLO-developed proposals or ADF review documents. To reduce the threat of ozone depletion, the U.S. and other nations have agreed to phase out the use of chloro-fluorocarbons, including the common refrigerants used by cold storage systems. Despite these concerns, the project documents did not contain evaluations of the potential problems created by refrigerants and potential mitigation through use of environmentally friendly alternative refrigerants.

According to ADF officials, the Foundation has significantly enhanced its capabilities for reviewing environmental assessments since these projects were approved in 1997. The officials added that the problems cited should be attributed to an oversight during document preparation. To help ensure that adequate environmental analyses are prepared when necessary, we are making the following recommendation.

Recommendation 2: We recommend that the African Development Foundation develop guidance to help its staff members recognize potential environmental issues when reviewing project proposals and develop procedures to ensure that staff members have verified that environmental analyses have been performed whenever warranted and that all issues of concern have been addressed.

Did the African Development Foundation implement a system to monitor grantee projects and obtain project results?

During fiscal year 2001, ADF did not implement an effective system to monitor its projects and obtain project results. ADF records indicated that CLO staff did not complete the recommended number of monitoring visits to each project. Contrary to ADF procedures, monitoring reports often did not indicate the progress grantees had made toward achieving each grant objective, and usually did not document steps needed to resolve issues that may be impeding project success. ADF officials noted that monitoring activities had been hampered by the Foundation's reorganization efforts during fiscal year 2001.

In addition, progress reports submitted by grantees did not always include accurate and useful information about cumulative progress against the baseline, annual or end-of-project objectives. In fiscal year 2001, ADF officials had recognized problems with both the report format mandated by ADF and the quality of progress data provided by grantees, but had not taken appropriate corrective action. As a result, during the period covered by this audit, the Foundation could not reliably determine if its programs were meeting objectives and would become sustainable.

ADF Needs to Improve Monitoring of Progress Toward Objectives

According to ADF policy, the Foundation was required to regularly collect and assess information related to the performance of its activities. Specifically, the Foundation would track, monitor, evaluate and report on each project's progress toward achieving its objectives and performance indicators. According to the policy, this information would allow the Foundation to "manage for results" and would, among other things:

- assist planning by identifying what worked and what did not;
- improve the implementation of projects by signaling when impact was less than anticipated and identifying possible problems; and
- enable ADF to comply with the Government Performance and Results Act.

To allow ADF Headquarters to track and document grantee progress toward objectives, ADF required CLOs to make periodic monitoring visits to each project. Foundation policy recommended that CLO staff conduct no less than three monitoring visits per year to individual projects funded by grants over $50,000 (twice per year if grants are under $50,000), although the frequency might vary depending on the needs of the group. During these visits, the CLO was to verify and report on the specific accomplishments of the project including progress made toward achieving each of the quantifiable objectives contained in the grant agreement.

In addition to tracking progress, monitoring visits were intended to facilitate prompt interventions to resolve issues that might be impeding project success. Each report was expected to document both follow-up actions that could be taken by the local CLO staff and the issues that would require action by ADF Headquarters officials. The CLO was required to submit each monitoring site visit report, along with a monthly report of CLO activities, to ADF Headquarters.

Monthly activity reports and monitoring reports located in project files showed that CLO staff visited 12 of the 18 projects reviewed at least three times during fiscal year 2001. CLO records showed that three of the remaining projects were visited twice, one project was visited only once, and two projects were not visited at all. In most cases, the CLO monitoring reports did not meet ADF's requirements. The reports usually did not address the grantee's progress toward each objective, and most reports lacked remediation plans for performance-related problems. According to CLO personnel, more site project site visits had been completed but had not been documented.

To ensure that the projects were monitored effectively and that reports received in Washington were accurate and complete, the Regional Director and Regional Managers also regularly visited ADF projects. Available records showed that, during fiscal year 2001, ADF officials made at least 18 trips to the four countries covered by this audit and visited 15 of the 18 projects selected for review by the auditors. In some cases, trip reports adequately documented the staff's monitoring activities. In other cases, the reports provided few details regarding staff activity, problems identified, or solutions proposed.

Despite site visits by CLO and ADF officials, 12 of the 18 grantees visited by the auditors were experiencing problems that had not been identified and addressed through ADF monitoring efforts. Examples are detailed below.

> **Benin 1092 – Cold Storage -** This grant, signed in September 1997, provided funds totaling $179,147 to help 10 members of a cooperative develop an enterprise to market fish and poultry. ADF bought the cooperative a cold storage warehouse, a generator, other needed equipment, and a reconditioned 20-ton refrigerated truck. The warehouse is capable of storing up to 90 metric tons of frozen fish and poultry.
>
> The cooperative was expected to generate substantial annual profits but, after four years of operations, had not yet reported a profit. Reported revenues were less than 10 percent of the target. According to project

records, the warehouse had never been filled at more than 2 percent of capacity. It was nearly empty when the auditors visited. The group's major source of revenue was the rental of the ADF-purchased refrigerated truck to competitors. The cooperative had hired employees (fish cleaner, cashier), although the project plan had stated that cooperative members would perform these tasks.

CLO records showed that CLO staff made four visits to the project in fiscal year 2001, although only two visits were documented. These site visit reports were not completed according to ADF guidelines and contained no mention of the low sales, and no remediation plan to address this problem. ADF records showed that the Regional Director and Regional Manager visited the project in March 2001 and that they had identified significant project implementation and management issues. However, although the site visit report noted that remedial technical assistance would be obtained for the project, the specific concerns were not included in the report.

In June 2001, the CLO hired an economic consultant to review the project. The consultant confirmed that the project activities were progressing slowly and the project was operating at a loss. The resulting report estimated that the weight of the stock in the cold storage facility between March and June 2001 was only 1.3 percent of capacity. The report also noted that the project did not have sufficient working capital to pay for electricity, water, salaries, and the insurance for the vehicle. In addition, the report stated that group members could perform the work of hired employees, thus reducing salary expenses.

Photograph of the underutilized cold storage warehouse in Benin.

The consultant's report included several recommendations to assist the group in raising additional capital, including seeking other donors or approaching financial institutions and adding more members. However, the report did not include any recommendations for improving sales to help the group develop a sustainable enterprise.

According to ADF records, the Regional Manager returned to the project in August 2001. However, the official's trip report did not indicate that actions were underway to ensure the profitability and sustainability of the cooperative.

Senegal 1098, Fish Marketing - In September 1997, ADF approved a grant to the Women's Communal Union totaling $173,403. The five-year grant sought to provide a reliable source of employment and increase revenue for the Union and participating community members through the establishment of a viable and sustainable perishable fish storage and marketing business. In addition, ADF expected to strengthen the organizational capacity of the Union to manage and sustain the enterprise after the completion of the grant. However, as of September 2001, four years after the grant was approved, the group had not sold any fish.

According to CLO records, the project was visited five times in fiscal year 2001. Three of the visits were documented, but the trip reports did not conform to ADF's reporting requirements. During the first visit, the CLO staff noted the lack of activity and group organization. The staff prepared a table with problems and recommended actions; however, no timeframe was given. According to available records, the CLO did not follow-up on these recommendations in two subsequent visits in July. An ADF Regional Manager also visited the project in March and July 2001, but these visits did not result in a remediation plan to ensure that the project would be profitable or sustainable.

Tanzania 1178, Salt - In September 1998, ADF approved a grant to provide the Tanzania Research and Salt Mine Cooperative up to $250,000 over six years for a salt production project. The ADF grant was used, among other things, for the development of salt evaporation ponds, the construction of an office and warehouse, and the procurement of transport. The project sought to create a medium-size salt production facility serving local and regional markets. Other specific objectives were to create permanent employment for the 32 members and seasonal employment for 20 others, increase the production of salt, and raise the average individual member's annual financial benefits.

Delays in installing the primary pump set back the project significantly, and the project had never reached expected production levels. The plant achieved between 10 percent and 16 percent of the goals set out in the agreement for the past three years. Due to the low production levels, the project had not been able to provide fulltime permanent employment for all 32 members. Rather, performance reports for fiscal year 2001 showed an average of 4 workers per period, and net member income was reportedly only 2 percent of the project's target. The electricity was disconnected for non-payment due to a disagreement over the bill rate. The seawater pump had not been regularly maintained and was covered by a good deal of rust. At the time of the audit, the pump had rusted and only the framing for the warehouse had been completed, precluding the storage of inventory.

According to the CLO records and the grantee, the project had been visited three times during fiscal year 2001. However, the CLO reports for these visits were not documented according to ADF requirements. For example, site visit reports did not include an evaluation of progress against all objectives or a clear remediation plan. According to ADF records, the ADF Regional Manager also visited the project in April 2001. As of April 2002, however, ADF had not developed a remediation plan for the project.

Uganda 1293, Garbage Recycling - In September 1999, ADF signed a grant agreement for a garbage recycling project (see description, page 11). After three years of operation, the project had never been profitable and had not achieved its objectives. For example, the grantee had achieved only ten percent of its garbage collection target and less than three percent of its fertilizer sales target. Nine of the 20 ADF-funded dumpsters were at the garbage sorting facility instead of being placed in the township where they could be used.

Photograph of two of the nine ADF-funded dumpsters in Uganda that were not in use.

The dumpsters that were in the township had been filled and emptied much less frequently than had been planned. Most of the garbage separation buckets that were intended for use by families living in the township had not been distributed. Moreover, the motor for a machine intended to sift compost had been removed and was unaccounted for and, as a result, women were sifting compost by hand.

Photograph of women sorting compost by hand because the motor for the ADF-funded sifting machine was missing.

These problems suggest that ADF needs to strengthen its oversight of project activities to help ensure the early identification of problems and the rapid remediation or prompt termination of grants, if necessary. Because ADF did not always closely monitor its projects, it did not always have accurate or timely information about projects experiencing problems and did not provide timely assistance to help grantees reach their objectives.

In addition, ADF did not have a system that provided for semiannual or annual project implementation reviews. There were no scheduled milestones to trigger a full review of all project information that might result in a decision to terminate project funding.

According to ADF officials, program monitoring during fiscal year 2001 was hampered by the Foundation’s focus on reorganization efforts. Foundation officials stated that ADF has begun developing procedures that will minimize the weaknesses and risks identified during this audit, including new requirements for site visits by ADF program staff and Partners.

Furthermore, ADF stated that it would conduct annual portfolio reviews of all projects. Those that are not making expected progress will be placed on a Watch List, and the ADF President will receive a quarterly report on the status of remediation activities. Projects with the most severe problems will be labeled as “At Risk” and are expected to receive more intensive monitoring and reporting to address the problems identified. Because these actions have not yet been implemented, we are making the following recommendation:

Recommendation 3: We recommend that the African Development Foundation implement revised policies to evaluate grantee progress toward grant objectives and facilitate prompt interventions to improve project results or terminate (if necessary) non-performing grants and provide the Office of Inspector General with documentation of the results of the first such portfolio review to take place after issuance of this report.

ADF Needs to Improve Results Reporting by Grantees

According to ADF policy, the Foundation will track, monitor, evaluate and report on the progress grantees make toward achieving project's objectives, and will systematically undertake performance assessments against project objectives and performance indicators. To facilitate these assessments, ADF required all grantees to submit a Project Activity Report (PAR) every four months that included information on cumulative progress against the baseline and end-of-project targets for each objective, as well as progress during the particular reporting period for all performance indicators.

Although grantees submitted the required reports, ADF officials did not always review the reports with sufficient care to ensure that the reported data was accurate, complete, and useful. Because of the problems listed below, several PARs reviewed during the audit could not be used to fully assess progress toward grant objectives. Identified problems included:

- annual performance described as cumulative life-of-project results;
- mathematical errors;
- unverified results; and
- lack of indicators for key program objectives.

Problems specific to the projects visited during the audit are detailed below.

Benin 1122, Print Shop - The grantee's PARs contained revenue statements that could not be reconciled with its accounting records. For example, the PAR for the period June to September 2001, reported revenues that were 22 percent higher than revenues reported in the grantee's accounting records. Also, the PAR did not accurately carry forward performance data from one period to the next, making it difficult to identify performance trends or measure progress toward achieving grant objectives.

The PAR reported results for revenue and depreciation (two of four quantifiable project objectives) but did not report member allowances or net profit objectives, which would have been useful indicators of the project's economic benefits and potential sustainability.

Senegal 1164, Credit Union - The grantee reported results in its PAR that could not be verified because it did not keep proper accounting records, information on results achieved could not be reconciled to its line item journal and its general ledger had not been updated since February 2001. Although PAR reports for fiscal year 2001 contained 42 indicators, there were no indicators for four of eight quantifiable objectives in the grant agreement. For example, the PAR did not report the group's progress toward objectives such as profit and member income.

Tanzania 1178, Salt - The grantee's PAR reported that a cumulative total of 32 members had been employed during fiscal year 2001. However, according to grantee records and interviews with grantee representatives, the project employed only four workers in fiscal year 2001. Also, there was no documentation supporting the salt production baseline indicator of 332 tons a year; the group's records indicated an average annual production of 233 tons before the start of the project.

Uganda 1293, Garbage Recycling - The grantee was required to report on 17 indicators, covering all of the project's objectives. However, the PAR for the period June through September 2001 did not accurately carry forward figures from the previous reporting period. The grantee had no records to support the reported amount of garbage collected, and the grantee's records did not support the amounts reported regarding fertilizer sales volume and revenue.

Also, the grantee calculated a monthly average for the garbage collected during this period. Rather than comparing this new average to the previous period's average to determine whether collections had increased or decreased, the grantee added the two averages together and reported that its average monthly collections had increased; in fact, average collections had dropped by more than 50 percent. The grantee's reported progress for fertilizer production and revenue also contained significant mathematical errors.

The PAR report also contained a per-month average for collections and sales that was obtained by dividing total figures for the four-month period by two instead of by four, thereby doubling the actual average monthly results.

ADF officials were aware of the shortcomings of the PAR system. For example, in a December 2000 report on projects in Tanzania, an ADF official reported that, in most cases, grantees were not collecting the full range of data required for their PARs. This report noted that grantees (1) sometimes had no verifiable basis for the data they reported, (2) had failed to report serious problems encountered, and (3) reported data that were not always comprehensible or reliable. In July 2001, another ADF official reported that that there were flaws in the results reporting chart developed for some projects in Tanzania. According to this report, outputs that should have been measured as annual rates were instead being reported as cumulative sums, rendering them "meaningless." In December 2001, an ADF official reported that the PARs in Uganda continued to provide unreliable and unsupported data regarding project progress, and recommended significant revisions to the reporting process and format. As of May 2002, the reporting system had not been revised.

ADF officials stated that its current results reporting process was too complex because some grantees did not have the technical skills needed to accurately maintain and calculate the needed data. ADF stated that it would revise and simplify its grantee reporting requirements. A new methodology will be reviewed in its entirety during an upcoming ADF conference.

Because ADF did not always receive accurate and complete information about project progress, it could not reliably determine if projects were meeting objectives and would become sustainable. In addition, because grantees did not always have accurate records to support submitted data, results were difficult to verify and ADF had only limited assurance that projects were obtaining the reported results.

> **Recommendation 4: We recommend that the African Development Foundation establish policies requiring periodic evaluation of the performance indicators developed for each project to ensure that all indicators are necessary and relevant.**

> **Recommendation 5: We recommend that the African Development Foundation provide grantees appropriate training to accurately maintain and report performance data.**

Did the African Development Foundation implement a system to audit funds provided to grantees?

ADF did not establish effective policies, procedures, and practices to audit funds provided to grantees. Because of weaknesses in its policies and its oversight practices, ADF did not ensure that (1) an appropriate number of audits were performed, (2) audits were conducted at the most appropriate time of a grant's life cycle, and (3) all grants over $50,000 were audited. While ADF selected local accounting firms in accordance with Foundation policy, the firms did not always incorporate all required work steps in their programs and did not perform, or did not properly document, several important accountability checks. Contrary to ADF policy, the ADF Internal Auditor did not conduct audits of the funds provided to CLOs in accordance with Government Auditing Standards or as often as required by ADF policy. Furthermore, ADF did not have a process that ensured that all significant audit recommendations were tracked and implemented.

According to ADF officials, because the Foundation was in a transition period from CLOs to Partner organizations during the past year, some aspects of the Foundation's audit program did not receive appropriate attention and were therefore not properly implemented. As a result, the audits provided limited assurance that grant funds were being used for intended purposes, and ADF did not have adequate assurance that the funds provided to grants were used only for approved purposes

ADF Needs to Improve the Audit Universe, Audit Selection Process, and Audit Timing

ADF's audit selection procedures targeted about one-fourth of all active grants for audit in fiscal year 2002. Half of the grants were to be selected randomly and half were to be selected by ADF managers from among those grants having a value of $100,000 or more. Although there was no requirement that every grant be audited, ADF officials stated that ADF would audit each grant over $50,000 before it expired.

To determine the minimum number of projects to be audited during fiscal year 2002, ADF calculated the number of "project starts" over the previous four years and divided that number by four. The resulting number established the minimum number of audits that would be planned, although more could be performed if appropriate. The list used by the Director of ADF's Office of Budget, Finance and Administration to perform this calculation showed that 177 grants had started since fiscal year 1998. One-fourth of this total was 44, and 46 grants were eventually selected for audit in fiscal year 2002. However, the list of active projects was incomplete and inaccurate. The actual number of "project starts" during the previous four years totaled 220 grants, and ADF should have performed at least 55 audits in fiscal year 2002. Instead, ADF selected 16 percent fewer grants for audit than would have been selected if an accurate list had been used.

ADF policy stated that half of the grants that would be audited would be selected randomly, and these grants were selected for audit without adequate regard to the status of their activities. As a result, some audits were completed before significant project activities had taken place, reducing the value of the audit. Other audits took place near project completion, thus reducing the opportunity for corrective intervention during the life of the grant.

In addition, due to the lack of a comprehensive audit plan, 13 grants over $50,000, with a total funding of $925,000, expired in fiscal year 2001 or fiscal year 2002 without being audited at all. ADF did not have reasonable assurance that these grant funds were used for intended purposes.

To preclude these anomalies in the future, ADF should establish new audit selection procedures that ensure that, at a minimum, all high value grants are audited and that these, and all other audits, are conducted at appropriate times during the lifecycle of the respective grants. The base for developing this plan should be a complete and accurate audit universe that contains such elements as:

- grantee name and country;
- award number, amount in U.S. dollars, and start/completion dates;
- information on any prior audits and periods covered;
- grant expenditures to date;
- date of planned audit(s); and
- date audit report should be received.

With a complete audit database available, ADF can then develop an audit plan as recommended below:

Recommendation 6: We recommend that the African Development Foundation establish a minimum threshold for the value of grants that will be audited and establish annual audit plans to ensure that, at a minimum, all grants that exceed the threshold are audited at an appropriate point during the grant lifecycle.

Recommendation 7: We recommend that the African Development Foundation provide its annual audit plan to the Office of Inspector General by October 1 of each fiscal year.

ADF Needs to Monitor the Quality of Grantee Audits

Five local public accounting firms audited projects in Benin, Senegal, Tanzania, and Uganda between FY 1998 and FY 2001. ADF selected these firms in accordance with Foundation policy for identifying qualified audit firms. However, although the firms were required to develop audit programs (a series of work steps) that complied with audit guidance provided to them by ADF, the firms did not always incorporate all required work steps in their programs. In addition the auditors did not perform, or did not properly document, several important accountability checks. Because of weak oversight practices, ADF was unaware that the auditors had not complied with ADF policies and guidelines. As a result, the audits provided limited assurance that grant funds were being used for intended purposes.

ADF had developed criteria to ensure that it selected qualified local accounting firms to audit the funds provided to grantees. The criteria required ADF to select accounting firms with appropriate professional affiliations, education, training, language capabilities, and experience with grassroots organizations. ADF followed its own policies and procedures in selecting the five local accounting firms whose audit work was reviewed during this audit.

Ordinarily, ADF selected and contracted with one qualified public accounting firm to conduct all grant audits in that country. According to ADF policy, the audit function should be re-competed every three years. ADF included funds to pay for grant audits in each grant budget and used those funds to pay for an audit of the grant, if the grant was selected for audit. ADF retained the designated funds and disbursed them directly to the accounting firm to pay for completed audits.

ADF provided substantial guidance to the firms it contracted to audit grant funds to help ensure that these audits would comply with U.S. Government Auditing Standards and Office of Management and Budget guidance. ADF's instructions for the conduct of audits were outlined in the detailed scope of work of each contract for audit services. The scope of work stated, in part, that audits must be performed in accordance with the Foundation's field audit guidelines. ADF required that the accounting firms complete the following activities during each audit:

- verify the accuracy and completeness of project expenditures,
- ascertain that there was full accountability for all project funds and assets,
- review and determine the adequacy of the internal controls,

- examine and report on the technical competence of project personnel to maintain accounting records, and

- review the grantee's financial statements to ensure that they were fair, reasonable and without obvious errors.

However, the firms did not always perform all required audit tasks. Examples from the eight grantee audits reviewed follow.

B**enin 1122, Print Shop -** The local accounting firm that audited this project kept no documentation related to several tasks that ADF had asked it to perform. Specifically, the firm had no working papers to show that auditors had (1) reconciled ADF's fund disbursements with the grantee's accounting records, (2) reconciled expenditures recorded in the general ledger to subsidiary ledgers, or (3) verified that the grantee's expenditures complied with the grant agreement budget. Also, the firm did not verify the existence and condition of fixed assets, or validate ownership of these assets. There was no documentary evidence in the firm's working papers to support three weaknesses noted in its audit report.

The accounting firm's audit program did not incorporate several of the requirements from ADF's audit guidelines into its audit program for this audit, and there was no evidence that the required work had been done. Also, contrary to ADF's guidance, the audit firm's workpapers did not demonstrate that auditors had verified that the work or travel that resulted in payments to individuals for wages, salaries or travel had actually occurred.

Senegal 1098, Fish Marketing - The audit report's statements of fact and conclusions were not adequately supported by evidence in the auditor's working papers. For example, the firm had no records showing that auditors had performed the work necessary to ascertain whether the grantee had complied with applicable laws, regulations, and provisions of the grant agreement. The firm also did not have records to show that it had reconciled ADF deposits to bank statements.

Uganda 1096, Heifer Project - The local accounting firm did not adequately complete all of the requirements of its contract with ADF. The firm did not, for example, comment on the following: (1) the staff's technical competence in terms of their ability to maintain accounting records, (2) the grantee's accounting system, and (3) salary payments made under the grant budget, verifying that the amounts reported were paid and that applicable employer tax and social security payments were made. Also, there was no evidence in the workpapers demonstrating that several steps in the audit program had been completed, including verifying that work or travel was performed in the case of payments to individuals for wages, salaries or travel.

The contracted auditors also did not include discussions of significant issues or discrepancies in their audit reports. For example:

Benin 1145, Sewing and Dressmaking - The audit report contained no discussion regarding questionable purchases of capital assets. The grantee had not obtained two bids prior to purchasing sewing machines and motorbikes, although competition was required by ADF policy. In addition, the grantee purchased the motorbikes from a local "Agricultural Products and Fish" consultant, rather than an authorized dealer, and paid the exact amount budgeted for their purchase. ADF had no assurance that the prices paid for the sewing machines and motorbikes reflected their value. The audit firm should have questioned these practices.

Uganda 1096, Heifer Project - Although the audit firm was required by the scope of work of its contract with ADF to establish whether expenditures are in accordance with the grant agreement, the firm did not report a significant discrepancy. The grantee had purchased a truck instead of purchasing the motorcycle and two bicycles that were authorized. The firm should have questioned the use of grant funds for this purchase and reported that there was no evidence of ADF Headquarters authorization for this change. In addition, the firm did not note that the truck was not appropriately registered in the name of the project as required by ADF policy.

Uganda 1193,Vanilla Project - The audit report had no discussion regarding the grantee's purchase of a pickup truck instead of the motorcycle approved by ADF. Also, the auditors did not report that the truck was improperly registered in the name of the former owner.

ADF did not implement procedures to review the quality of work performed by these local accounting firms to ensure that the audits were complete, accurate or performed in accordance with ADF guidance. ADF did not review of the firms' audit programs or workpapers. ADF also did not contact the accounting firms to discuss the status of audit work or ensure that all work was completed and that findings were appropriately supported.

As a result, ADF's audit program provided limited assurance that project funds were being used for the intended purposes. Because the auditors did not always, as required by the scope of work, confirm that internal controls were in place and functioning properly, there was increased risk that funds were used improperly.

Recommendation 8: We recommend that the African Development Foundation establish and implement specific policies and procedures for an audit quality control program designed to ensure that audits are completed in accordance with Foundation requirements and appropriate audit standards.

ADF Needs to Improve Audits of In-Country Partners

Contrary to ADF policy, the ADF Internal Auditor did not conduct audits of the funds provided to ADF's local Country Liaison Offices (CLOs) in accordance with Generally Accepted Government Auditing Standards (GAGAS) or as often as required by ADF policy. This occurred because ADF's audit organization does not have an appropriate internal quality control system in place to assure compliance with appropriate standards. As a result, ADF had limited assurance that CLO funds were being used for the intended purposes.

ADF required that its Internal Auditor audit each CLO biennially and complete a number of specific checks and procedures during each audit. Although each CLO audit report stated that the audit had been conducted in accordance with GAGAS, the four reports reviewed (the most recent CLO audit reports for Benin, Senegal, Uganda and Tanzania) were not compliant with GAGAS and ADF policy. Specifically:

- the audit reports did not contain an expression of an opinion or an assertion to the effect that an opinion could not be expressed;

- the reports lacked a complete scope and methodology section that stated the periods covered by the audits and the nature and extent of the auditor's procedures;

- the Internal Auditor's workpapers contained no record of the audit objectives, scope and methodology, or other evidence of appropriate audit planning;

- the workpapers did not show evidence that major audit procedures required by ADF policy had been completed by the auditor, including (1) physical verification that items of significant value had been purchased or built, (2) random sampling and testing of at least ten transactions, and (3) verification of the accuracy of the amounts reported for significant expenditures; and

- the workpapers did not show evidence of supervisory review or that the auditor followed-up prior audit findings and recommendations.

Furthermore, CLO audits were not completed as often as required by ADF policy. CLOs in 8 of 14 countries (57 percent) were not audited as often as required. Although audits were conducted every other year in Benin, Ghana, Mali, Niger, Tanzania and Uganda, there was a three-year gap between audits in Botswana, Cameroon, Guinea, Lesotho and Namibia, and a four-year gap between audits in Cape Verde, Senegal and Zimbabwe.

GAGAS require each audit organization conducting audits to have an appropriate internal quality control system in place. The internal quality control system established by the audit organization should provide reasonable assurance that it (1) has adopted, and is following, applicable auditing standards, and (2) has established, and is following, adequate audit policies and procedures. ADF had no such internal quality control system. The Internal Auditor worked alone, and his work was not subject to the supervisory review required to assure compliance with GAGAS.

As a result, ADF had limited assurance that CLO funds were being used for the intended purposes. ADF has replaced CLOs with new in-country entities called Partners. Because Partners are subject to the same audit procedures as CLOs, the findings and recommendations in this report are equally applicable to them. To ensure that the Partner audits are completed on time using appropriate standards, we are recommending that these audits be included in the ADF annual audit plan and conducted by an external auditor, as follows:

> **Recommendation 9: We recommend that the African Development Foundation develop procedures to ensure that audits of Partner organizations are included in the Foundation's annual audit plan.**
>
> **Recommendation 10: We recommend that the African Development Foundation contract with qualified U.S. or local accounting firms to conduct audits of funds provided to Partners and that these audits be subject to consistent and appropriate quality control review by the Foundation's Internal Auditor.**

ADF Needs To Improve Its Audit Recommendation Tracking Process

ADF did not have a process that ensured that all significant audit recommendations were implemented. OMB Circular A-50 requires audit officials to oversee the work of non-federal auditors that is performed in connection with federal programs. The Circular requires that agencies "resolve" or develop plans to address all audit recommendations[2] within six months of report issuance. Agencies must also maintain accurate records of the status of audit reports or recommendations. The Circular also requires that the head of each agency receive semi-annual reports regarding, among other things, the status of unresolved audit recommendations and the monetary benefits resulting from audits.

According to ADF policy, an Audit Committee - composed of the ADF's Office of Budget, Finance, and Administration (OBFA) Director, the Foundation's President, the General Counsel and other ADF senior managers- was responsible for promptly reviewing each grantee audit report and determining what follow-up actions were required. The Audit Committee would also receive a quarterly status report from the OBFA Director, which was based on information provided by ADF Regional Directors.

However, the Audit Committee did not review audit reports as required, and ADF did not appropriately track recommendations to ensure that corrective actions took place. No Audit Committee meetings were held during fiscal year 2001 and the OBFA Director did not maintain a record of audit recommendation status or actions taken by the grantees. As of May 2002, only 7 of 32 significant audit recommendations for the reviewed projects had been implemented. These recommendations were contained in audit reports issued between October 1999 and May 2001.

Examples of recommendations that had not been addressed are detailed below.

Benin 1136, Brick and Tile - This project was audited in July 2000. The audit report noted that (1) the project's products were not competitive because the prices (profit margin) were too high, (2) a fence had not been built around the work area, (3) the grantee had no insurance on project assets, (4) the grantee had poor accounting records, (5) there was insufficient control over the use and rental of the ADF-funded truck, and (6) the grantee was not following local requirements related to employee declarations for payroll, social security insurance, and taxes from the fees paid to service providers.

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[2] A variety of organizations may issue audit recommendations that ADF must address. For example, the OIG and the General Accounting Office have reviewed ADF operations and provided recommendations to ADF management. The OIG also contracts a public accounting firm to audit ADF's annual financial statements and the resulting recommendations, if any, must also be addressed. Finally, ADF must ensure that the recommendations of the U.S. or local accounting firms that it contracts to audit grant funds are addressed by grantee or ADF officials, as appropriate.

As of March 2002, nearly two years later, these recommendations had not been implemented. The grantee had not altered the price structure, even though sales of bricks and tiles were 95 percent below targets for fiscal year 2000 and fiscal year 2001. A fence had not been put up around the work area, and the grantee had not obtained insurance for project assets. The grantee's accounting records did not reconcile with data reported to ADF, additional controls had not been placed on the use and rental of the project's truck, and the grantee had not complied with tax law provisions.

Similar recommendations regarding compliance with local tax laws were included in audits of five additional projects in Benin, Senegal and Tanzania. None of these projects were in compliance at the time of the fieldwork for this audit.

Senegal 1164, Credit Union - An audit of this project in November 2000 disclosed numerous findings concerning the accuracy and timing of reports, record keeping, and voucher accuracy. However, as of April 2002, the grantee had not followed-up on the audit recommendations, including ensuring that the general ledger and grantee financial reports were properly reconciled.

Tanzania 1171, Women's Credit Union - An audit of this project issued in May 2001 found that the grantee had not prepared a loan aging schedule and that, rather than calculating the loan repayment rate, the grantee was using an estimated repayment rate. As of April 2002, a loan aging schedule was still not available, and the loan repayment rate could not be reconciled with the estimated rate reported to ADF.

In December 2001, ADF's Audit Committee met to discuss the status of audits performed during fiscal year 2001. Since that time, ADF has developed a database of major audit recommendations and clarified procedures and responsibilities for verifying grantee responses to the recommendations. However, the database was incomplete, as it did not include (1) audit recommendations from audits issued prior to fiscal year 2001, or (2) all major audit recommendations made to grantees, such as those from audits in Tanzania. Also, the database did not include audit recommendations resulting from CLO audits. Furthermore, ADF did not complete semi-annual reports of audit recommendation status as required by OMB Circular A-50.

According to ADF officials, the formal tracking of audit recommendations during fiscal year 2001 did not take place due to staffing problems. The Foundation had no Financial Control Officer, who is responsible for managing the audit recommendation database, for much of the year.

Because audit recommendations were not tracked and implemented, ADF had limited assurance that its projects had effective internal controls and were operating in accordance with local laws and regulations. Unless ADF tracks recommendations and takes necessary corrective action (as required by OMB Circular A-50), there is increased risk that funds could be misused. Although ADF has taken steps to improve the process, additional systemic improvements are needed to allow ADF to manage, and the OIG to supervise, the Foundation's audit process.

To ensure that audit recommendations are appropriately tracked and implemented, ADF needs a more effective audit recommendation tracking system for all audits of ADF funds and operations. The tracking system should include recommendations from audits performed or supervised by the OIG and the General Accounting Office, as well as audits performed by firms under contract to the Foundation. Such a system would provide ADF with greater accountability for audit reports and recommendations, and ensure that the OIG can adequately maintain its supervisory role over the process.

Recommendation 11: We recommend that the African Development Foundation establish policies and procedures for an audit follow-up system that is in compliance with the Office of Management and Budget Circular A-50 requirements, including the semi-annual reporting of audit recommendation status. These procedures should ensure that a copy of these semi-annual reports be provided to the Office of Inspector General.

Management Comments and our Evaluation

In its response to our draft report, ADF management concurred with our recommendations and described the actions the Foundation has planned or undertaken to address them. When fully implemented, these actions should significantly improve the Foundation's selection, monitoring and audit processes.

To address our recommendations regarding program selection (Recommendation Nos. 1 and 2), ADF officials noted that the Foundation is implementing a comprehensive plan for strengthening economic appraisal of project proposals at the identification, development, review, and implementation stages. ADF is revising its environmental policy and developing new procedures and guidelines to assess the environmental implications of project proposals.

To improve the Foundation's grant monitoring system (Recommendation Nos. 3, 4 and 5), ADF management is planning a new policy to assess grantee progress toward grant objectives and facilitate prompt intervention. This policy relies on effective monitoring of project implementation and portfolio reviews. The revised policy on monitoring and evaluation will require routine evaluation of project performance indicators during portfolio reviews, the annual program impact exercise, and any time a project is amended. In addition, the review of quarterly progress reports may trigger the evaluation of project indicators.

To address our concerns related to the audits (Recommendation Nos. 6– 11), ADF management agreed to develop an annual audit plan that will be submitted to the OIG. In addition, ADF officials plan to issue revised policies and procedures for its audit quality control program, and will also incorporate applicable audit standards.

ADF disagreed with our finding that the Foundation's current audit recommendation tracking system was not in compliance with OMB Circular A-50, but agreed to expand the recommendation tracking and reporting system to include grants and cooperative agreements. We maintain that Circular A-50 requires that these audits be included in the tracking and reporting system, and agree that the proposed actions will bring the Foundation into compliance with the OMB guidance.

Based on ADF's comments, we conclude that management agreement has been reached regarding all recommendations.

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Scope and Methodology

Scope

This audit had three objectives, which were to determine if the African Development Foundation (ADF) had (1) evaluated and selected proposals for funding in accordance with Foundation policies and procedures, (2) implemented a system to monitor the progress of grantee activities, and (3) implemented a system to audit funds provided to grantees. The Office of Inspector General's Performance Audit Division, Regional Inspector General/Pretoria and Regional Inspector General/Dakar conducted this audit in accordance with generally accepted government auditing standards.

Our audit included a detailed review of 18 of ADF's 248 active projects that were located in 4 of the 13 countries with ADF operations during fiscal year 2001 – Senegal, Benin, Tanzania and Uganda. The countries were selected to ensure that at least one country from each of ADF's three management divisions was included in the review. Specific projects were selected to (1) provide geographic coverage within each country, (2) provide an adequate distribution between micro-finance and micro-enterprise grants, and (3) allow us to focus on larger grants. In order to evaluate past monitoring efforts, only projects that had expended more than 50 percent of grant funds through fiscal year 2001 were included in our sample. We reviewed ADF's fiscal year 2002 audit program because data for the fiscal year 2001 audit program were not readily available. We reviewed the activities of the ADF Internal Auditor during fiscal year 2001, and reviewed ADF's most recent audit reports completed for 13 Country Liaison Offices (CLOs). ADF concurred with this scope.

We reviewed significant management controls related to the selection and monitoring of the 18 projects in our sample. These controls included (1) ADF's process for evaluating proposals submitted by the CLO, and (2) the Foundation's process for monitoring grantee progress and preparing progress indicator data during fiscal year 2001. In a few cases, complete documentation for the selection process had not been retained and we made judgements based on the evidence available.

We evaluated the effectiveness of ADF's audit program as a management control. We reviewed specific controls related to the fiscal year 2002 audit program, including (1) the process for developing the audit universe, (2) quality control efforts related to audits by accounting firms in four countries, (3) the process for tracking and closing audit recommendations, and (4) quality control procedures for the eight audits completed for projects in our sample.

Fieldwork for this audit took place in Washington, D.C. from February 2001 until August 2002. Fieldwork in Uganda and Benin was completed during March 2002, and fieldwork in Tanzania and Senegal was completed from April to May 2002.

Methodology

In order to achieve the objectives of this audit, we met with ADF officials in Washington and CLO/Partner representatives in four African countries. In addition, we conducted site visits to 18 active grantees, observed their project's operation and interviewed grantee representatives. We interviewed auditors at five local firms that had been responsible for audits of grants within our sample. In addition, we completed the following steps:

- reviewed the audit findings from previous OIG audit reports;

- reviewed and documented applicable ADF policies for selecting, monitoring, and auditing grants;

- evaluated documents from CLO and ADF grant files, including project papers and feasibility studies, to determine if the selection process was consistent with ADF polices;

- verified, based on source documents and grantee records, performance and financial data included in grantee progress reports;

- determined whether major capital assets had been properly purchased and controlled;

- obtained and reviewed CLO monitoring reports on file in Africa and on file at ADF, as well as the progress reports submitted by each grantee in our sample;

- obtained and reviewed travel documents and trip reports by ADF Regional Directors and Regional Managers, and verified reported project status;

- evaluated whether or not projects were meeting objectives, using as a materiality threshold the expectation that projects would meet at least 60 percent of their targets for production, revenue and profit;

- reviewed credentials and qualifications of accounting firms for conformance with ADF policies;

- reviewed workpapers and audit reports for conformance to ADF requirements and compliance with quality control standards;
- tested the 2002 audit universe and audit level against data available in the ADF project database;
- verified follow-up of audit recommendations for the projects in our sample (including on-site verification); and
- evaluated 13 CLO audits by the ADF Internal Auditor for conformance with applicable audit standards.

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Management Comments

AFRICAN DEVELOPMENT FOUNDATION

January 31, 2003

MEMORANDUM

TO : IG/A/PA, Dianne L. Rawl

FROM : Nathaniel Fields, ADF President

SUBJECT : Audit of the Awarding and Monitoring of Grants by the African Development Foundation (Report No. 9-ADF-03-00X-P) .

Please find below the African Development Foundation's (ADF's) response to the subject audit report. We have keyed our responses to the eleven recommendations in the report.

You will notice that in most instances, ADF has initiated actions consistent with the report's recommendations. This is because over the last two years, ADF has engaged in a major restructuring of its administrative and program operations to address some of the issues discussed in the report. For example, since 2000 ADF has made a concerted effort to enhance its economic and financial analysis expertise, and hence improve the quality of project proposal development and review. We have adopted more stringent guidelines for project design and monitoring. In addition, based on an intensive self-assessment of its grant financial management policies and procedures in 2002, ADF will implement a more comprehensive financial management program for grants and cooperative agreements, of which audits are an important component.

The audit was performed during a transitional period for ADF and unavoidably, for the most part, covers operations during the pre-transition state. Last fiscal year, we witnessed measurable improvements from our piloting of new draft policies, procedures, and guidance that the audit could not have captured. With the adoption and implementation of these policy and procedures, we expect to see even greater returns to performance this fiscal year and beyond.

We appreciate the time and attention the Office of the Inspector General (OIG) has devoted to this audit.

ADF Responses to OIG Report No. 9-000-03-00X-P

Recommendation 1: We recommend that the African Development Foundation develop procedures that require that staff members who have been trained to evaluate the economic assumptions of project proposals participate in project development and reviews.

ADF Position: We concur.

Discussion: ADF has begun implementation of a comprehensive plan for strengthening economic appraisal of project proposals at the identification, development, review, and implementation stages. This plan focuses on enhancing human resources and strengthening procedures. We wish to note that the projects covered in the audit were approved before this plan went into implementation.

1.1. Project Proposal Review

Calendar year 2000 was pivotal in the Foundation's transition from a strategic focus on social impact to income generation. One reason for this is ADF's recruitment of the first two of its cadre of economists. Each individual recruited for a program-related position since then has expertise in economic and/or financial analysis. Currently, five of the fourteen Washington staff that performs program-related functions has economic and/or financial expertise. As evidenced by project review memoranda, since late 2000 project review groups have increasingly scrutinized proposals for their economic viability.

By March 31, 2003, ADF will issue revised procedures for review of project proposals. Under the new procedures, only a properly constituted Project Discussion Group (PDG) will be able to conduct the formal review of a project proposal and make a recommendation on whether to fund a proposal. A properly constituted PDG will require the participation of the individuals with expertise in economics and finance, in addition to individuals with expertise in environment/natural resources management, monitoring and evaluation, the relevant sector or technical area, e.g., micro and small enterprise development, trade and investment, HIV/AIDS.

The new procedures will set out requirements for issue papers, the PDG meeting agenda, and the PDG review memorandum. These requirements will help to ensure that review committees devote adequate attention to economic and other project viability issues. For instance, PDG members will formulate issues papers in terms of questions pertinent to project viability, including economic viability. The PDG agenda will be structured to ensure adequate discussion of economic and other feasibility issues. The PDG memorandum will report the results of the meeting by issue area, stating specifically if there were economic, financial, technical, social, environmental, legal/regulatory, or group capacity issues, and if so, discussing the issues.

1. 2 Project Development and Implementation

In consultation with the Foundation's staff, Partner organizations provide technical expertise to applicants during proposal development and to grantees during project implementation. While all Partners have sufficient financial expertise on their staffs, some do not have the requisite economic expertise. By the end of the current Fiscal Year, each Partner will have the requisite economic expertise among its staff or will have entered into a long-term arrangement for the assistance of external expertise in economics.

Partner organizations will be expected to remain current on national and regional economic issues in their countries to facilitate project development and advise grantees during implementation. In program countries where ADF has trade and investment programs, Partners must also have adequate knowledge of international economic issues, as they relate to the program.

In 2002, ADF adopted the logical framework (LogFrame) as an analytical tool to guide project proposal development and the formulation of monitoring and evaluation plans. ADF trained its Washington staff and the Partner staffs in the use of the LogFrame. The LogFrame specifically directs project designers (and reviewers) to identify and assess the soundness of project assumptions, including economic ones.

By February 28, 2003, ADF will issue new guidelines for the presentation of project proposals (PPs). The guidelines will require project proposals to provide the analytical underpinning for the LogFrame. They will require a separate analysis of the economic feasibility of the proposed project.

1.3 Project Screening.

In addition to taking actions that will ensure reliable economic appraisal at the proposal development and review stage as stipulated in the Inspector General's (IG's) Recommendation 1, the Foundation has extended the requirement for economic appraisal the proposal to the screening process, i.e., the first stage of the award process. ADF has hired Field Representatives in twelve countries. Training and demonstrated expertise in economic and financial analysis is a mandatory requirement for those selected as ADF Field Representatives. One of the representatives' major functions is to conduct the initial screening of grant applications. New screening criteria, which ADF will issue by March 31, 2003, will include questions on early indicators of economic viability.

Recommendation 2: We recommend that the African Development Foundation develop guidance to help its staff members recognize potential environmental issues when reviewing project proposals and develop procedures to ensure that staff members have verified that environmental analyses have been performed whenever warranted and that all issues of concern have been addressed.

ADF Response: We concur.

Discussion: ADF is revising its environmental policy and developing new procedures and guidelines to assess the environmental implications of project proposals. These guidelines will be issued along with the revised guidance for project development in February 2003. Since 2000, ADF has included conditions precedent to disbursement in its grant agreements, as appropriate, that assist the Foundation complies U.S. Environmental Protection Agency and international standards for protection of the environment, as appropriate.

Recommendation 3: We recommend that the African Development Foundation implement revised policies to evaluate grantee progress toward grant objectives and facilitate prompt interventions to improve project results or terminate (if necessary) non-performing grants and provide the Office of Inspector General with documentation of the results of the first such portfolio review to take place after issuance of this report.

ADF Response: We concur.

Discussion: By March 31, 2003, ADF will have in place a new policy to assess grantee progress toward grant objectives and facilitate prompt intervention. This policy relies on effective monitoring of project implementation and portfolio reviews.

3.1 Project Monitoring

Grantees will submit a quarterly Progress/Activity Report (PAR) to the ADF Field Representatives with a copy to the ADF Partners. This report has two components:

- A description of the grantee's activities during the quarter. Specifically, the report will discuss actions the grantee took to address problems or issues identified earlier by the grantee, the Partner, or ADF, and the results of the actions taken. In addition, the report will discuss contact with or visits by the ADF Representative or Partner; and
- An assessment of grantee progress toward meeting the objectives of the grant. This will include a report on the quantifiable measures and indicators established in the LogFrame, a narrative discussion of the progress indicated by the measures and indicators, and a discussion of other progress. The report will include a discussion of any problems and issues the grantee encounters and proposed solutions.

In addition, the Partners and ADF Field Representatives will conduct routine visits to project sites:

- During project start up, the Partner will finalize a monitoring plan. This plan will call for two to three site visits during the first year of each project and one to two visits annually for subsequent years. The purpose of the site visits is to provide advice and assistance on project implementation to the grantee, identify any issues or concerns the grantee needs to address and discuss alternative solutions, and ensure the project is well managed. The site visits consist of meetings with the grantee's members and management, assessment of the physical plant and equipment, assessment of any technical assistance provided, performance of contractors, and performance of the grantee's monitoring and evaluation committee on the self-assessment activities (in projects with grantee monitoring and evaluation committees).
- The ADF Field Representative or ADF headquarters staff will visit each project annually, at a minimum. These visits will focus on compliance and verification issues, including

verifying the accuracy of grantee quarterly progress reports (in addition to financial management and accountability issues). The individuals making the site visits will prepare reports identifying issues, concerns, and follow-up actions required.

3.2 Grant Portfolio Reviews

In October 2002, ADF instituted a new policy that calls for annual review of the project portfolio in each program country. The first such review will take place in June 2003. The review will focus on implementation issues, progress towards project objectives, and the results of project monitoring. The results of the portfolio review group's analysis will place a project in one of the following four categories.

- Performing Projects. These are projects that are making satisfactory progress achieving their objectives and comply with all requirements. They will be subjected to routine monitoring.
- Watch Projects. These projects are not making expected progress toward their objectives, or have minor compliance or implementation problems. Projects on the Watch List will receive a heightened level of monitoring. The Field Representative or Washington staff will prepare a remediation plan identifying the problem(s) and setting out a plan for corrective action. The office preparing the remediation plan will submit a quarterly report to the ADF President on the status of the remediation.
- At Risk Projects. These are projects that have serious problems. While ADF has yet to develop specific criteria for identifying these projects, sample criteria may include the following: (a) financial or progress report is more than 60 days late; (b) failure to reach 75 percent of the project's targets for two or more consecutive quarters; and (c) reported or apparent management or group cohesion problems. ADF will subject these projects to more intensive monitoring and reporting than Watch Projects, and will require the implementation of certain activities to address the problems identified. In addition, ADF will hold a special portfolio review each quarter for projects on the "At Risk" list.
- Proposed Terminations. The portfolio review group may recommend termination of a project. This may result from a variety of circumstances, such as the following: (1) theft of project resources; (2) misrepresentation of a material fact by the grantee; (3) breach of material terms and conditions of the grant agreement; (4) inability of the grantee to implement the project; and (5) it becomes apparent that the project, as designed, is not viable and cannot be made viable.

Recommendation 4: We recommend that the African Development Foundation establish policies requiring periodic evaluation of the performance indicators developed for each project to ensure that all indicators are necessary and relevant.

ADF Response: We concur.

Discussion: The revised policy on monitoring and evaluation that takes effect on March 31, 2003 will require routine evaluation of project performance indicators during portfolio reviews, the annual program impact (API) exercise, and any time a project is amended. In addition, the review of quarterly progress reports may trigger the evaluation of project indicators.

Recommendation 5: We recommend that the African Development Foundation provide grantees appropriate training to accurately maintain and report performance data.

ADF Response: We concur, but with qualification.

Discussion: It is a long-standing ADF policy to train all new grantees on maintaining and reporting performance data. Under this policy, the Partner's (and prior to that Country Liaison Officer's) staff trains the grantee's monitoring and evaluation committee in performance reporting. However, as indicated on page 25 of the OIG's report, ADF has determined that the reporting format is too complex for most grantees. This, we believe is the root problem that needs attention. Consequently, we will issue a revised reporting format by March 31, 2003. The Partners will continue training grantees in performance reporting. Through review of progress reports and site visits the Field Representatives will continuously assess the grantees performance reporting, and make recommendations on a course of action when reporting is not satisfactory.

Recommendation 6: We recommend that the African Development Foundation establish a minimum threshold for the value of grants that will be audited and establish annual audit plans to ensure that, at a minimum, all grants that exceed the threshold are audited at an appropriate point during the grant cycle.

ADF Response: We concur, but with qualification.

Discussion: ADF's new policy for audit selection becomes effective on February 1, 2003. This policy eliminates the minimum threshold criterion. In accordance with its grant financial management program, ADF will include each grant in the audit universe at the time of grant award. In addition, any grant that was active on February 1, 2002 will be included in the audit universe. This means all grants, regardless of their value, will undergo either an independent external audit or an ADF internal audit at the appropriate time during their life cycle. For each grant, ADF will compare the value added of an independent external audit to that of an ADF internal audit to determine which is warranted.

Recommendation 7: We recommend that the African Development Foundation provide its annual audit plan to the Office of the Inspector General by October 1 of each fiscal year.

ADF Response: We concur.

Discussion: For fiscal year 2004 and beyond, ADF will provide an annual audit plan to the Office of the Inspector General by October 1. We will present the fiscal year 2003 plan by May 31, 2003. The plan will extract information from the grant audit universe, using established evaluation and selection criteria.

Recommendation 8: We recommend that the African Development Foundation establish specific policies and procedures for an audit quality control program designed to ensure that audits are completed in accordance with ADF requirements and appropriate audit standards.

ADF Response: We concur.

Discussion: By May 31, 2003, ADF will issue revised policies and procedures for its audit quality control program. These new directives will help ensure that ADF's audits are conducted in accordance with ADF requirements and appropriate audit standards. In addition, ADF is reorganizing its management expertise to make certain that its staff expertise is deployed as to promote effective implementation of the new policies and procedures.

Recommendation 9: We recommend that the African Development Foundation develop procedures to ensure that audits of Partner organizations are included in the Foundation's annual audit plan.

ADF Response: We concur.

Discussion: In accordance with ADF's comprehensive financial management of grant and cooperative agreement policy that takes effect on March 31, 2003, each Partner organization will be included in the grant audit universe at the time of award. Since the Partners must undergo an annual independent audit, they will appear yearly in the Foundation's annual audit plan.

Recommendation 10: We recommend that the African Development Foundation contract with qualified U.S. or local accounting firms to conduct audits of funds provided to Partners and that these audits be subject to consistent and appropriate quality control review by the Foundation's Internal Auditor.

ADF Response: We concur.

Discussion: ADF requires Partner organizations to contract with firms on USAID's list of "Audit Firms Eligible to Perform Non-Federal Financial Audits." Partner organizations in countries not covered by the USAID referral list must get approval from ADF before contracting with an audit firm. This policy was implemented in January 2003.

By March 31, 2003, ADF will issue revised procedures for audit quality control reviews. These procedures will incorporate applicable standards of generally accepted government auditing standards (GAGAS), and when applicable generally accepted accounting standards (GAAS). By April 2003, ADF will redeploy its audit management Washington staff to ensure the quality of the audits.

Recommendation 11: We recommend that the African Development Foundation establish policies and procedures for an audit follow-up system that is in compliance with the Office of Management and Budget Circular A-50 requirements, including the semi-annual reporting of

audit recommendation status. These procedures should ensure that a copy of these semi-annual reports be provided to the Office of the Inspector General.

ADF Response: We concur with the recommendation, but disagree with the findings.

Discussion: The ADF audit follow-up program complies with the Office of Management and Budget (OMB) Circular A-50. In August 2000, ADF established and implemented an audit follow-up system in compliance with OMB Circular A-50. ADF designated a staff member to manage the audit follow up process and provide semi-annual reports to the head of the agency. Based on the Office of the Inspector General's FY 2002 Chief Financial Officer audit of financial statements, ADF is in compliance with OMB Circular A-50. However, the follow-up process does not cover audits of grants and cooperative agreements. ADF agrees to broaden the scope of its audit procedures to include these audits.

SUMMARY ADF RESPONSE TO AUDIT REPORT 9-000-03-00X-9

No.	OIG Recommendation	ADF Response	Corrective Action	Estimated Final Action Date
1	We recommend that the African Development Foundation develop procedures that require that staff members who have been trained to evaluate the economic assumptions of project proposals participate in project development and reviews.	Concur	Revised procedures for review of project proposals. All Partners acquire reliable access to economic expertise Revised proposal screening criteria	March 31, 2003 September 30, 2003 March 31, 2003
2	We recommend that the African Development Foundation develop guidance to help its staff members recognize potential environmental issues when reviewing project proposals and develop procedures to ensure that staff members have verified that environmental analyses have been performed whenever warranted and that all issues of concern have been addressed.	Concur	Revised environmental policy, procedures, and guidelines	February 28, 2003

3	We recommend that the African Development Foundation implement revised policies to evaluate grantee progress toward grant objectives and facilitate prompt interventions to improve project results or terminate (if necessary) non-performing grants and provide the Office of Inspector General with documentation of the results of the first such portfolio review to take place after issuance of this report.	Concur	Revise policy on assessment of grantee progress toward grant objectives	March 31, 2003
4	We recommend that the African Development Foundation establish policies requiring periodic evaluation of the performance indicators developed for each project to ensure that all indicators are necessary and relevant	Concur	Revised monitoring and evaluation policy	March 31, 2003
5	We recommend that the African Development Foundation provide grantees appropriate training to accurately maintain and report performance data.	Concur, with qualification	Revised grantee reporting format	March 31, 2003

6	We recommend that the African Development Foundation establish a minimum threshold for the value of grants that will be audited and establish annual audit plans to ensure that, at a minimum, all grants that exceed the threshold are audited at an appropriate point during the grant cycle.	Concur, with qualification	Revised audit selection policy	February 1, 2003
7	We recommend that the African Development Foundation provide its annual audit plan to the Office of the Inspector General by October 1 of each fiscal year.	Concur	Prepare annual audit plan and submit to OIG	May 31, 2003 (FY 2003 plan) October 1, 2003 (FY 2004 plan)
8	We recommend that the African Development Foundation establish specific policies and procedures for an audit quality control program designed to ensure that audits are completed in accordance with ADF requirements and appropriate audit standards.	Concur	Revised audit quality control policies and procedures	May 31, 2003
9	We recommend that the African Development Foundation develop procedures to ensure that audits of Partner organizations are included in the Foundation's annual audit plan.	Concur	Revised policy to include Partner agreements in audits universe Establish comprehensive financial management policy	March 31, 2003 March 31, 2003

10	We recommend that the African Development Foundation contract with qualified U.S. or local accounting firms to conduct audits of funds provided to Partners and that these audits be subject to consistent and appropriate quality control review by the Foundation's Internal Auditor.	Concur	Policy on eligible firms for audit of Partner organizations	Implemented January 2003
11	We recommend that the African Development Foundation establish policies and procedures for an audit follow-up system that is in compliance with the Office of Management and Budget Circular A-50 requirements, including the semi-annual reporting of audit recommendation status. These procedures should ensure that a copy of these semi-annual reports be provided to the Office of the Inspector General.	Concur with recommendation, but disagree with finding	Include audit of grants and cooperative agreements in the OMB Circular A-50 report. Revised procedures for quality control reviews	May 31, 2003 March 31, 2003