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Report to the Chairman, Subcommittee
on Foreign Operations, Export
Financing and Related Programs,
Committee on Appropriations, House of
Representatives

October 1991

FOREIGN ASSISTANCE

African Development Foundation's Grant Funds Are Not Routinely Audited



**National Security and
International Affairs Division**

B-245437

October 29, 1991

The Honorable David R. Obey
Chairman, Subcommittee on Foreign
Operations, Export Financing
and Related Programs
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

This report responds to your request, and that of the former Majority Whip, that we review the African Development Foundation's (ADF) grant audit practices. Specifically, you asked that we determine whether (1) ADF ensures that its grantees have the ability to keep track of grant funds, (2) required audits of ADF's grant funds have been performed, and (3) ADF has resolved the problems found during these audits.

Background

ADF is an independent, nonprofit government corporation established to provide financial assistance to grass-roots organizations in Africa. Since it became operational in 1984, ADF has awarded 259 grants totaling about \$22.4 million. Each ADF grant is limited by law to \$250,000. Through fiscal year 1990, the average grant value was approximately \$86,700, and the average project took about 38 months.

In May 1989, ADF established an audit policy requiring that the grantee's ability to maintain adequate accounting records and support documentation be assessed at the beginning of the grant award period. These assessments are referred to as "bookkeeping reviews." ADF also requires that each grant of \$50,000 or more receive initial, interim, and final audits. According to the former Director of Administration and Finance, prior to May 1989, ADF officials selected grants for audit based on their judgment of the risk involved and of whether the grant funds appeared to have been spent for the intended purposes.

Results in Brief

ADF generally did not conduct required bookkeeping reviews. Of the 25 grantees receiving a grant of \$50,000 or more since May 1989, only 5 had received a bookkeeping review. ADF also did not conduct required

initial financial audits.¹ Only 2 of 25 active grants received an initial audit. In addition, 11 completed grants, totaling about \$1.4 million, had not been audited at all. Finally, ADF did not systematically document its follow-up and resolution of bookkeeping review and audit findings. ADF noted changes it has made, and intends to make, regarding its audit policies and record-keeping.

Few Bookkeeping Reviews Were Performed

According to ADF audit policy, bookkeeping reviews are to be conducted by independent auditors on contract with ADF. The reviews are intended to determine whether the grantee can effectively manage the grant project, account for grant funds, and meet ADF's record-keeping requirements. We found that only 5 of the 25 grantees receiving a grant awarded since May 1989 had received the required bookkeeping review. Of the five completed reviews, only two resulted in approval of the grantees' accounting and record-keeping systems.

ADF policy allows bookkeeping reviews to be waived when the grantee proves that it has an accounting and record-keeping system that can effectively track disbursed funds. However, ADF does not provide specific guidance on what evidence needs to be presented to justify a waiver or how this evidence should be documented. For the 20 grants that did not receive bookkeeping reviews, ADF could not locate any documentation supporting the conclusion that the grantee had the ability to maintain the necessary accounting records and backup files.

The need to conduct bookkeeping reviews is demonstrated by the following complaints raised by ADF's auditors regarding the inadequacy of grantees' accounting records and supporting documentation for claimed expenditures:

- A still-active 1986 grant of \$223,018 to a training center in Benin was considered impossible to audit because the grantee lacked a structured accounting and administrative system. An audit 1 year later found that the grantee was still not complying with the requirements of the grant agreement.
- The only audit of a completed 1987 grant for \$250,000 to a fishing cooperative in Togo stated that the grantee had not maintained books and had not adhered to the grant agreement in the area of "control and judicious use of resources."

¹An "initial audit" is to be done within 4 months of the completion of the bookkeeping review or, when the review is waived, within 4 months of the initial disbursement of funds.

- The only audit to date of a still-active 1989 grant for \$199,462 to an artisans' cooperative in Niger showed that the project had not established an acceptable accounting system. The auditors stated that they could not "attest that all the funds have been entirely utilized for the project purpose."

ADF officials told us that these types of problems still existed.

ADF audit policy requires that all completed bookkeeping reviews be reviewed and appropriate steps taken to correct any problems identified. However, ADF provided no guidance on what, when, or how assistance would be provided to a grantee.

We noted that, despite this lack of guidance, a number of ADF regional managers had requested technical assistance for the grantees they managed. ADF had also conducted a number of 3-day workshops for grantees, which included training on financial management requirements. In addition, ADF's Director of Financial Management told us that he had developed an instructional package for grantees that will provide guidance and a standard format for making general ledger entries and recording cash and check disbursements. ADF was considering including this package in its grant audit policy, but, at the time of our review, no decision had been made.

Agency Comments and Our Evaluation

In commenting on a draft of this report, ADF agreed that bookkeeping reviews were not being performed. Instead, ADF said, it was satisfied with assessments by its regional managers conducted during the application process. We noted, however, that ADF's policy guidance did not refer to this type of assessment, nor did ADF provide guidance on how regional managers should evaluate a grantee's accounting and record-keeping capabilities.

We reviewed the regional manager's project assessments for the 20 grants that did not have bookkeeping reviews and found that 17 did not include a detailed discussion of the grantee's accounting and record-keeping capabilities. In 18 cases, however, the regional manager recommended that technical assistance be provided to improve the grantee's abilities in these areas. We did not determine whether the technical assistance was provided, but, as noted previously, ADF could not locate documentation supporting its decision to waive a bookkeeping review

for any of these grants. Such documentation should have included evidence that the grantee was provided with appropriate technical assistance.

Grant Funds Were Not Routinely Audited

ADF's audit policy requires that independent auditors perform (1) an initial financial audit within 4 months of the completion of the bookkeeping review or, when the review is waived, within 4 months of the initial disbursement of funds; (2) a financial audit about every 12 months after the initial audit; and (3) a final audit when the grant is completed.

We reviewed 25 grants—all the grants that were \$50,000 or more and awarded under ADF's current audit policy—to determine whether the initial audits had been done. We found that only 1 of the 25 grants had received an initial audit within the prescribed 4 months. One additional grant had been audited after the 4-month period.

Initial audits may be waived when the results of the bookkeeping review show that the grantee has systems and procedures sufficient to properly account for ADF funds. However, if the bookkeeping review is waived, the initial audit may not be. ADF officials were not able to locate any approved waivers or other documentation to justify why initial audits had not been done for the remaining 23 grants.

We also noted inadequate audit coverage for a significant portion of ADF's completed grants. ADF's former Director of Administration and Finance told us that prior to the adoption of the May 1989 audit policy, his goal had been to have most grants of \$50,000 or more receive one audit. Of the 56 completed grants of \$50,000 or more, 11 had not been audited. Totaling about \$1.4 million, these 11 grants ranged in value from \$56,119 to \$249,270; 7 exceeded \$100,000. In addition, the first and sometimes only audit for 19 of the completed grants had not been done until 2 years or more after the first grant disbursement was made. In 11 of these cases, the audit revealed serious record-keeping or financial reporting problems that should have been remedied much earlier.

Agency Comments and Our Evaluation

ADF agreed that it had not adhered to its policy of conducting annual and final audits on all projects over \$50,000. According to ADF, it generally did not do audits because the stringent application of its policy was not consistent with the limited size and nature of its operations. ADF also said that the audits that were done were often high cost and limited in

usefulness. As a result, ADF has undertaken a full-scale revision of its audit policy to ensure timely audit of ADF projects, appropriate and realistic audit timetables and guidelines, and prompt review of audit findings.

In revising its policy, ADF management is responsible for ensuring that the financial audit system safeguards against waste, fraud, and abuse. The internal controls established under the policy must provide a satisfactory level of confidence that the audit system will meet this objective, given consideration of costs, benefits, and risks. An essential internal control for providing such reasonable assurance is that all significant events of an agency, such as waivers granted for financial audits, be documented.

ADF Did Not Systematically Document Follow-up and Resolution Actions

As previously noted, when ADF bookkeeping reviews and financial audits were done, they frequently revealed serious problems. Many pertained to inadequate accounting systems, nonexistent financial records, unbudgeted expenditures, and disallowed costs. ADF headquarters officials are responsible for ensuring that such findings are resolved in a timely manner. Specific follow-up actions are normally implemented by ADF's regional managers or by its country liaison officers stationed in 16 African nations.

Before January 1990, ADF's follow-up system relied on the efforts of an internal audit committee to review and resolve all bookkeeping reviews and financial audits.² Committee minutes show that audit reports were routinely reviewed and that specific follow-up actions were identified. However, the committee did not record the findings it reviewed in any systematic manner, did not formally delegate responsibility for their resolution, and had no formal means of tracking the status of follow-up actions.

According to ADF's May 1989 audit policy, the Director of Administration and Finance is supposed to schedule an audit committee meeting to review bookkeeping reviews and audit reports not later than 1 month after their receipt. However, according to ADF's former Director of Administration and Finance, the audit committee stopped holding meetings in January 1990 because of the inordinate amount of time required

²The audit committee is comprised of the Director of Financial Management, the Directors of the Office of Program and Field Operations, the General Counsel, and the cognizant regional manager and grant analyst.

to review bookkeeping reviews and audit reports. The committee members decided that the review and follow-up function should be combined with ADF's semiannual grant review process, which entails a detailed review of each active grant by a panel of senior ADF managers.

This process, however, was generally unsatisfactory for tracking findings and implementing corrective actions. In May 1990, ADF's Director of Administration and Finance wrote that he did not think that these reviews had been adequately focused or that follow-up activities had been clearly defined.

In June 1990, ADF's Director of Administration and Finance directed the return to the previous system of having the audit committee review bookkeeping reviews and audit reports. Through August 1991 the audit committee had met once. ADF still has no mechanism for systematically tracking follow-up activities through resolution.

Agency Comments and Our Evaluation

ADF agreed that systematic documentation of follow-up and resolution of audit findings needs to be addressed. ADF's Director of Financial Management told us that he planned to initiate an automated scheduling and tracking system that will show the status of outstanding findings. This is planned to be completed in 1992.

Recommendations

To provide greater accountability over ADF's grant funds, we recommend that ADF's President ensure that

- evidence of the grantee's accounting and record-keeping capabilities are documented by bookkeeping reviews, written waivers for bookkeeping reviews, or assessments by ADF regional managers;
- waivers for financial audits are documented; and
- follow-up and resolution of findings from bookkeeping reviews, regional manager assessments, and financial audits are documented in a systematic manner.

Scope and Methodology

We interviewed ADF officials and reviewed related program documents in ADF's Headquarters in Washington, D.C. We reviewed (1) all active grants (a total of 25) valued at \$50,000 or more, awarded after May 1989, and at least 1 year old and (2) all completed grants (a total of 56) valued at \$50,000 or more. We did not independently assess whether ADF's grants were achieving their intended purposes. Rather, we

examined each grant file to determine whether the requisite bookkeeping reviews and initial, interim, and final audits had been performed. When we did not find the required bookkeeping reviews and audits, we notified ADF officials and afforded them the opportunity to locate the missing documents or to provide evidence of approved waivers. We also did not seek to verify that ADF followed up and resolved all bookkeeping review and audit findings for the grants we reviewed.

We conducted our review between May and August 1991 in accordance with generally accepted government auditing standards. ADF's comments on a draft of this report are reprinted in appendix I.

We are sending copies of this report to the President of ADF; the Chairmen of the Senate and House Committees on Appropriations, the Senate Committee on Foreign Relations, and the House Committee on Foreign Affairs; other appropriate congressional committees and Members of the Congress; and the Director, Office of Management and Budget. We will also make copies available to other interested parties.

Please call me on (202) 275-5790 if you or your staff have any questions regarding this report. Other major contributors to this report were Albert H. Huntington, III, Assistant Director; Michael ten Kate, Evaluator-in-Charge; and Muriel Forster, Evaluator.

Sincerely yours,



Harold J. Johnson
Director, Foreign Economic
Assistance Issues

Comments From the African Development Foundation



AFRICAN DEVELOPMENT FOUNDATION

September 26, 1991

Mr. Frank C. Conahan
Comptroller General, National Security
and International Affairs Division
United States General Accounting Office

Dear Mr. Conahan:

I have reviewed the draft report entitled *Foreign Assistance: African Development Foundation Grants Are Not Routinely Audited*, and offer the following comments regarding its contents.

First, I would like to compliment Ms. Muriel Forster, the auditor, on the professionalism and consideration she displayed during her time at the Foundation. She performed her duties without unduly disrupting the work of the office or inconveniencing any of my staff. As this has been a time of great activity at the Foundation, both in terms of project funding and administrative reorganization, her unintrusive and courteous style was greatly appreciated.

The report to Congressman Obey's Subcommittee on Foreign Operations, Export Financing and Related Programs, indicates that it is responding to three issues: (1) whether ADF ensures that its grantees have the ability to track grant funds; (2) whether audits required by ADF policy have been performed; and (3) whether ADF has resolved the problems found during the audits.

Regarding each of these issues, my response will, I believe, demonstrate that:

- While the report is correct in stating that ADF does not routinely use auditors to perform bookkeeping reviews, other more cost effective alternatives have been developed to assess and track the ability of grantees to account for grant funds;
- There are good reasons why ADF practice has not been consistent with its audit policy, but a reform of the policy, based on past experience, is in progress; and,
- Adequate documentation of audit follow-up activities has, as the report notes, been a problem which ADF must address; however, it is important to note that such follow-up does in fact take place.

ISSUE #1. ASSESSMENT OF GRANTEE CAPACITY FOR ACCOUNTABILITY

The report states that, "ADF did not conduct required bookkeeping reviews." The ADF audit policy promulgated in May 1989 requires auditors to conduct initial bookkeeping reviews of ADF grantees. Application of this policy has proven impractical and difficult to implement.

ADF has contracted with local accounting firms to audit its projects since 1986. Very early on, it became apparent from the reports submitted by these firms that many of the projects implemented by grassroots groups could not be formally audited because they did not keep systematic accounting records. Consequently, efforts were made to introduce bookkeeping reviews and training where needed to correct this situation.

However, experience has shown that using auditors for this purpose is an expensive and inefficient means to deal with the problem. Over time, a new policy has evolved.

Presently, an assessment is done by the Country Liaison Officer and Regional Manager at the time a group applies for ADF funding to determine whether its membership has the skill and experience needed to keep complete and accurate financial records for the proposed project. If a project is approved for funding and the implementing group has been identified as lacking in this capacity, technical assistance in accounting and financial management is built into the project budget to assist the group in reaching the required level of accounting proficiency. This not only allows ADF to maintain fiscal accountability for the projects it funds, but strengthens the group's capacity to manage its own development.

The diverse accounting and financial management capabilities of ADF grantees requires a flexible approach to meeting their needs for assistance. Workshops, the assignment of an accountant to a project on a weekly or monthly basis, or extensive training in bookkeeping and accounting for one or more project managers are some of the means of providing technical assistance which the Foundation has employed.

The adequacy of technical assistance selected for an individual project is monitored by ADF staff through frequent site visits and an analysis of quarterly financial reports required under the grant agreement. Experience has shown that this system is more efficient and cost-effective than the earlier policy requiring auditors to do bookkeeping reviews for projects which are already underway.

ISSUE #2. ADF AUDIT POLICY AND PRACTICE

The report indicates that the Foundation has not adhered to its stated policy of conducting annual and final audits on all projects over \$50,000, unless the requirement has been expressly waived by the Director of Administration and Finance. The report's conclusion agrees completely in this regard with my own findings when I became President of the Foundation in February of this year.

**Appendix I
Comments From the African
Development Foundation**

The requirement that projects over \$50,000 be audited by African audit firms has been in place since 1986. Between 1986 and 1989, when the current policy was formulated, the identification of projects requiring audits, and the frequency in which they were to occur, was determined by the Director of Administration and Finance.

In 1989, a more stringent and formalized audit schedule was put in place to demonstrate ADF's commitment to fiscal accountability in its project funding. Unfortunately, experience has shown that the policy required a commitment of staff time and funds which was neither consistent with the Foundation's limited resources, nor commensurate with the results obtained.

Initially, the staffing requirements of such a stringent audit program were not recognized. Consequently, an already overburdened staff member was assigned the task of overseeing the audit program in 19 countries, involving over 100 projects. As a result, audit scheduling and follow-up to ensure the timely submission of required reports suffered.

In addition, intervening circumstances made audits difficult to schedule or complete. Auditors traveled to remote locations to visit grantees, only to find that the necessary accounting records or personnel for the projects were not on site, or in some of the earlier projects, did not exist at all. In some instances, weather, political unrest, and in at least two cases, war made the performance of scheduled audits impossible.

ADF found that audit reports received in Washington were sometimes incomprehensible, or focused on trivial record-keeping issues, rather than on whether the project inputs had been purchased, or whether the project was achieving its objectives. This reduced the reports' usefulness as a tool for ensuring grantees' financial accountability.

Finally, travel costs and the generally high daily rates charged by African audit firms, made the process inordinately expensive. Had the policy been rigidly adhered to, it is entirely possible that in some cases, adhering to the audit schedule established in ADF's policy guidelines could result in costs equal to half the value of the project.

Thus, it has become increasingly unrealistic and impractical for ADF to follow the formal audit policy it imposed upon itself. The consequent decline in the number of audits, as documented in the report, has been the result. I will address the measures we have taken to put in place a more realistic alternative to the present policy, at the conclusion of my response.

**ISSUE #3. SYSTEMATIC DOCUMENTATION OF FOLLOW-UP AND
RESOLUTION ACTIONS**

The report states that the Foundation does not systematically document its follow-up of audit findings. While I agree that documentation is a problem which ADF must address, this conclusion ought not be interpreted to imply that follow-up activities do not take place. ADF takes audit findings very seriously, and makes their resolution a priority in its project monitoring process.

Appendix I
Comments From the African
Development Foundation

Primary responsibility for carrying out follow-up action is assigned to the Regional Managers and Country Liaison Officers with assistance from other staff as appropriate. Documentation of the follow-up is contained in trip reports, telexes and other communications. Since this information is not filed with the audit reports or copied into the records of the Office of Financial Management, it is often not readily accessible.

A centralized system for documenting audit follow-up will be an integral part of the new fiscal control policies and procedures which are currently under development.

CONCLUSION

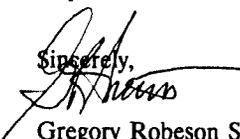
In concluding, I would like to briefly point out the steps that I have taken since becoming President of ADF in February, to redesign the audit program to more realistically and efficiently meet the Foundation's need for financial oversight of its grants, and to address weaknesses recognized by the Foundation and summarized in the GAO draft report.

Shortly after my arrival at ADF, I required the Office of Financial Management to assign a staff member to work exclusively on audit scheduling and follow-up. I also retained the services of a finance consultant to review ADF's fiscal policies and practices, including overseas audits. Finally, I ordered a review and summary of all pending audit reports in order to identify exactly where the Foundation is with respect to the requirements set forth in its policy guidelines.

As a result of these reviews and my conversations with Ms. Forster during the course of her work here, I have decided that a full-scale revision of ADF audit policy is required. I have asked the Foundation's Vice President, Carroll Bouchard, to head a task force of ADF managers, to design a system of controls, using auditors, ADF personnel, and external technical assistance providers, to ensure the timely audit of ADF projects; appropriate and realistic audit timetables and guidelines; prompt review of audit findings; and centralized documentation of any follow-up required.

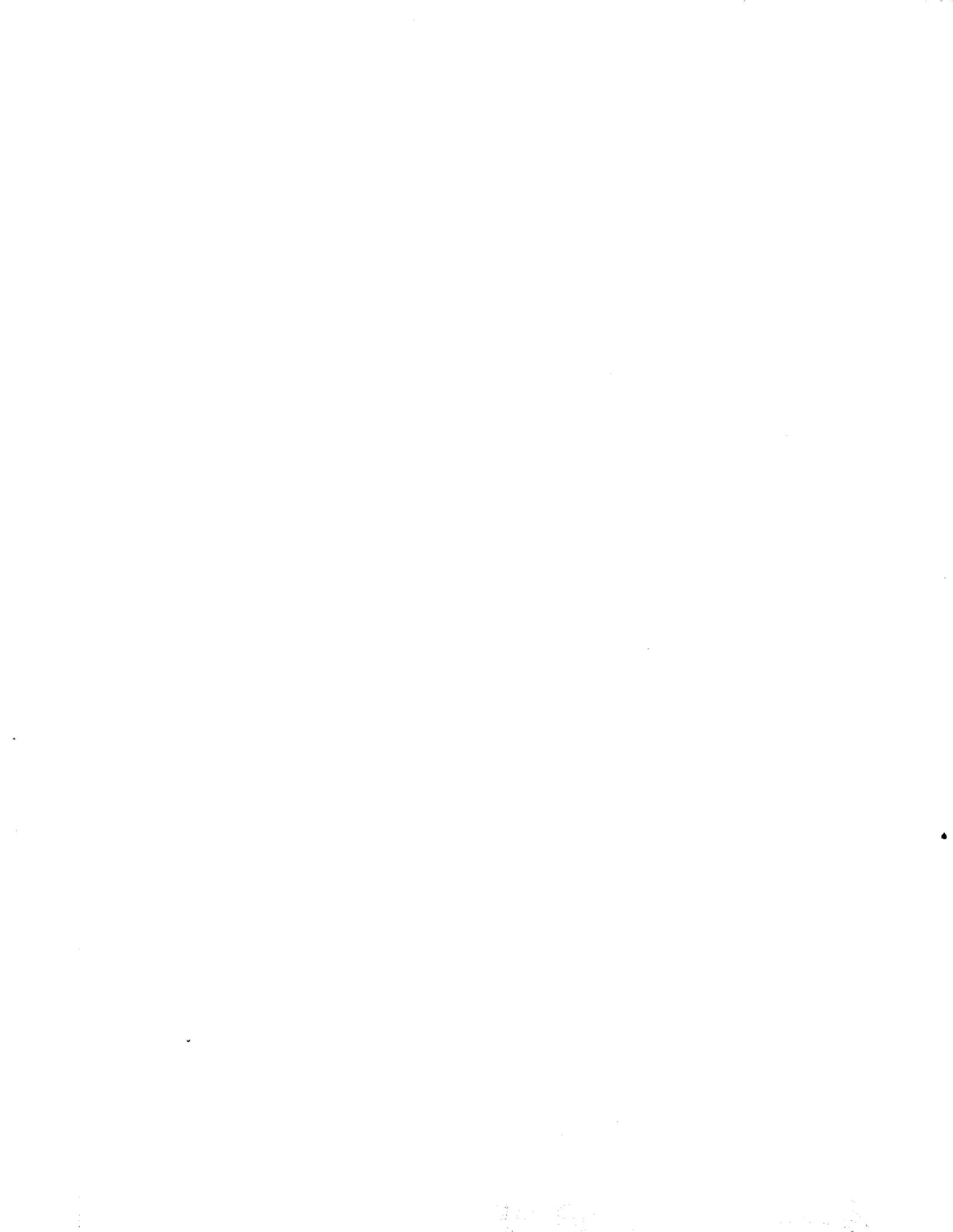
Finally, in a recent personnel reorganization of the Foundation, I have created an Office of Financial Audits, reporting directly to the Chief Financial Officer, which will be solely responsible for coordinating ADF's overseas audit program. By centralizing the function, I hope to ensure that audit policy is implemented so as to become a meaningful management tool for achieving the objectives of our program.

Thank you for giving me this opportunity to respond to the issues raised in the draft General Accounting Office Report. I hope that my remarks will be helpful.

Sincerely,


Gregory Robeson Smith
President

GRS:PSM:jkm



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