
**Interim Audit Report on USAID/Bosnia-Herzegovina's
Financial Stabilization Program Activity**

**Audit Report No. B-168-00-003-P
December 27, 1999**

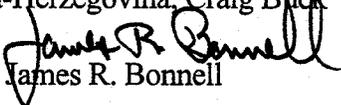


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December 27, 1999

MEMORANDUM

TO: USAID/Bosnia-Herzegovina, Craig Buck

FROM: RIG/Budapest,  James R. Bonnell

SUBJECT: Interim Audit Report on USAID/Bosnia-Herzegovina's Financial Stabilization Program Activity

This is an interim report on the subject audit. The report concludes, based on our interim audit results, that not all intended recipients were receiving their full entitlements. The three areas of non-compliance concern: (1) improper deductions to the net salaries; (2) grant funds used to pay transportation costs; and (3) salaries paid in Yugoslavian Dinars. The report makes one recommendation

In finalizing the report, we considered your comments on the draft report and included them in their entirety in Appendix II. Although you agreed with our findings and recommendation we consider the recommendation without a management decision at this time. A management decision can be reached after providing additional details as to the specific corrective actions taken in collaboration with the Office of the High Representative to correct the problems identified in the report. Please advise us within 30 days of such actions.

Thank you for the assistance and courtesies extended to my staff during the audit.

Background

The recent conflict in Kosovo in the Federal Republic of Yugoslavia severely affected the political and economic conditions in Bosnia and in particular the Republika Srpska (RS). Consequently, USAID/Bosnia-Herzegovina agreed to provide \$17 million to the Government of the RS and \$5 million in economic support funds to the Government of the Federation of Bosnia-Herzegovina to meet short-term revenue shortfalls resulting from the Kosovo crisis. Funding is to be provided under a new activity, the Financial Stabilization Program Activity. On July 8, 1999, USAID/Bosnia-Herzegovina approved a grant for \$10 million to the Office of the High Representative (OHR) to provide budget support in the RS. OHR, in turn, provides the funds to the RS for salary support for employees of the Ministries of Education and Refugees and Displaced Persons. Approximately 21,000 people employed by these two Ministries are to receive payments from the budget support

funds, with over 95 percent going to employees of the Ministry of Education.

OHR has primary audit oversight of the program, although USAID retains the authority to undertake additional audits if necessary. USAID/Bosnia-Herzegovina implemented a similar program during the summer of 1998 and at the Mission Director's request, RIG/Budapest audited that program¹. The Mission requested RIG/Budapest to provide similar audit coverage of this program.

Audit Objective

The objective of this audit was to determine if USAID/Bosnia-Herzegovina and the Office of the High Representative ensured that the intended recipients of USAID's Financial Stabilization Program Activity actually received their entitlements. Appendix I contains a discussion of the scope and methodology for the audit.

Audit Findings

Did USAID/Bosnia-Herzegovina and the Office of the High Representative ensure that the intended recipients of USAID's Financial Stabilization Program Activity actually received their entitlements?

Based on our interim audit results, for the items tested, not all recipients were receiving their full entitlements. Specifically, we found that, contrary to the grant agreement, (1) some schools were improperly withholding a portion of funds to use for teachers' union dues and/or a municipality tax; (2) one school improperly used funds to pay transportation costs for teachers traveling long distances; and (3) visiting professors at two schools received their salary payment in Yugoslavian Dinars rather than Konvertible Marks.

Interim Audit Tests Disclosed Some Problems

In July 1999, USAID/Bosnia-Herzegovina transferred \$5 million (approximately 9 million Deutsch Marks) of the approved \$10 million grant to a separate OHR bank account to cover the June and July salary payments for selected government employees in the RS. The remaining \$5 million was transferred to OHR on August 25, 1999, to cover salary payments for August and September. OHR planned to disburse the funds in three tranches² after completing the pre- and post-disbursement tests required by their audit plan. By late August, funds for the June salary payments had been disbursed.

¹ See Interim Report No. B-168-98-002-S, dated June 25, 1998, and Audit Report No. B-168-99-002-P, dated January 22, 1999.

² A tranche consists of one monthly payment to the Ministries of Education and Refugees and Displaced Persons for payment of employees' net salaries.

RIG/Budapest and OHR auditors established a joint team to determine whether recipients received their full salary entitlement for June. From August 30 through September 9, 1999, the joint audit team visited 24 establishments—21 educational facilities and 3 ministry offices—which had received approximately \$183,000 in salary payments for 1,195 employees. The audit team interviewed 113 of the 1,195 public employees approved for payment by the Republika Srpska. As summarized below, the interviews disclosed that some recipients were not receiving their full entitlements.

- Some educational institutions made improper deductions to the net salaries. The grant agreement specifies that funds shall be used only to pay net salaries. No payment of income taxes or social security contributions, such as pension, health, employment, child care or social fund costs shall be made using grant funds. However, the audit team found that eight educational institutions were improperly withholding union dues and six were improperly withholding municipal taxes from the net salary payments.
- Grant funds were used to pay transportation costs. Again, as stipulated in the grant agreement, funds shall be used only to pay net salaries. The audit team found, however, that one educational institution improperly used funds to pay transportation costs for teachers.
- Some salaries were paid in the wrong currency. According to the agreement between OHR and the Government of Republika Srpska, financial aid provided to the RS was to be disbursed to beneficiaries [recipients] in Konvertible Marks. However, two educational facilities paid the salaries of visiting professors via bank transfers in Yugoslavian Dinars because the recipients did not have accounts that would accept Konvertible Marks.

The joint audit team briefed USAID/Bosnia-Herzegovina officials on the audit findings and OHR provided a draft letter of actions required to correct the problems detected during site visits. On October 14, 1999, the Office of the High Representative issued a letter to the Minister of Finance of the Republika Srpska that: (1) reiterated the conditions that USAID established for the use of the \$10 million grant, (2) summarized the violations revealed during site visits, and (3) requested immediate corrective action.

According to the October letter, the Ministry was to inform all beneficiary institutions that they were to refund any portion of the grant that was paid for the teachers' union dues, municipality tax, and transportation costs. The Ministry was also to make it clear that it is never permissible to use the grant funds for anything other than net salary payments. Furthermore, the appropriate accountant was to be notified that all payments must be made in Konvertible Marks, including payments to visiting professors. OHR planned to review the August salary payments and document that the necessary refunds were made. However, the U.S. Ambassador placed a hold on the funds from which August and September payments would be made until the Government of the RS provides assurances that it is ensuring that no petroleum, oil, and lubricants are being exported from the RS to the Federal Republic of Yugoslavia. Consequently, OHR was unable to test the effectiveness of corrective action by the Minister of Finance and it is unclear when it will be able to do so. Accordingly, we are making the following recommendation.

Recommendation No. 1: We recommend that USAID/Bosnia-Herzegovina verify that the Office of the High Representative has documentation showing that appropriate actions were taken to correct problems found during the review of June salary payments.

Status of Program Activities Subsequent to Audit Fieldwork

OHR and USAID/Bosnia-Herzegovina officials provided RIG/Budapest updates on grant and program activities subsequent to our fieldwork. As of November 26, 1999, grant funds had been used to make June and July³ salary payments in the RS, but the Ambassadorial hold on funds for the August and September payments was still in effect. As a result, the RS Government paid the August and September salaries from its own funds, and, according to OHR officials, will also pay the October salaries. According to OHR, if the hold is reversed by mid-December, grant funds could be used to pay the November salaries and, barring further holds, could also pay December salaries toward the end of January. The OHR audit team plans to do extensive testing of all four payments from the \$10 million in grant funds.

As of November 26, 1999, USAID/Bosnia-Herzegovina had not yet obligated the remaining \$12 million of the planned \$22 million in budget support funds to be provided under the Financial Stabilization Program Activity. USAID/Bosnia-Herzegovina was waiting for OHR to submit a budget and for a final resolution of the U.S. Ambassador's conditions under which \$7 million would be provided to the RS. Also, Mission officials advised that they planned to draft a grant agreement for \$5 million for budget support funds to the Federation once they receive a budget from OHR and information on Ambassadorial conditions.

Management Comments and Our Evaluation

USAID/Bosnia-Herzegovina agreed with the report findings and recommendation and its comments are included as Appendix II to this report. In its response, USAID/Bosnia-Herzegovina stated that it will take steps, in collaboration with the Office of the High Representative, to ensure that corrective action is taken.

Although USAID/Bosnia-Herzegovina agreed with the report findings and recommendation, we consider the recommendation without a management decision at this time. Once additional details are provided by the Mission as to the specific actions it takes, in collaboration with the Office of the High Representative, to correct problems noted by the interim audit then a management decision can be made.

³ At the time of our fieldwork, July salary payments had not been made.

SCOPE AND METHODOLOGY

Scope

We audited USAID/Bosnia-Herzegovina and the Office of the High Representative to ensure that the intended recipients of USAID's Financial Stabilization Program Activity in the Republika Srpska (RS) received their entitlement. Our audit was performed in accordance with generally accepted government auditing standards. Fieldwork was conducted between August 23 and September 10, 1999, at the offices of USAID/Bosnia-Herzegovina and the Office of the High Representative (OHR) in Sarajevo. In addition, we performed site visits and interviewed program recipients at various high-risk locations in the RS. Our fieldwork covered only the June salary payments for approved government employees in the RS, since July payments had not been made. The June payments accounted for approximately \$2.5 million of the \$10 million grant.

OHR Audit Plan and Implementation

During the pre-disbursement phase, the OHR auditors intended to determine if:

- the salary requests from the RS were accurate and properly documented;
- no indicted war criminals were included on the lists; and
- the bank processing these funds had established a separate account for each ministry.

During the post-disbursement phase, the OHR auditors intended to determine if:

- the net salary total for each ministry was deposited to the correct bank account;
- disbursements from these accounts were evidenced by an authorized request from the responsible ministry's cashier; and
- withdrawals from these accounts equaled the total of funds requested.

In addition, the plan required OHR to select a sample of employees to confirm that the correct net salary was received.

Using OHR's plan as a guide, we reviewed OHR's audit workpapers for the testing performed prior to disbursement of the June 1999 salary support payment and determined that OHR auditors properly executed the pre-disbursement phase of their plan. For example, we found that OHR auditors ensured that a complete list of names and pertinent salary information had been obtained from the two Ministries that received budgetary support from USAID. Moreover, the workpapers indicated that OHR had reviewed these lists to ensure that no indicted war criminals were included on them. We also

noted that separate bank accounts had been established for USAID funds, and that only qualified Ministries under the terms of the grant were approved for budgetary support.

Methodology

Audit methodology included file review, interviews, field visits, and data analysis. We reviewed the grant agreement between USAID/Bosnia-Herzegovina and OHR and interviewed officials of both organizations to determine program objectives and restrictions. We reviewed the OHR audit plan to determine the extent of our testing. We also conducted site visits to beneficiary institutions in the Republika Srpska and interviewed recipients of June salary payments. We relied extensively on the work of the OHR auditors to answer our audit objective.

Regarding our reliance on the OHR auditors, we satisfied ourselves as to the completeness of their work, competence and objectivity. We reviewed the OHR audit plan and workpapers to determine if the plan was adequate and properly implemented and if the workpapers were a fair presentation of the work performed. In addition, we jointly interviewed 113 public sector employees to test whether the designated recipients of the Financial Stabilization Program Activity actually received their entitlements for the June 1999 salary payment. The employees selected for interview in this judgmental sample were concentrated in the more high-risk areas located in the eastern portion of the Republika Srpska which is characterized as less western oriented, poorer, and having a higher concentration of refugees.

Comments on the draft audit report provided by USAID/Bosnia-Herzegovina



United States Agency for International Development
Sarajevo, Bosnia and Herzegovina

December 2, 1999

MEMORANDUM

TO: James R. Bonnell, RIG/Budapest

FROM: Craig G. Buck,  Mission Director

SUBJECT: Interim Audit of USAID/Bosnia-Herzegovina's Financial Stabilization Program Activity

Thank you for bringing to our attention your findings on the subject audit. We agree fully with your auditors' findings and the subsequent recommendation, and will take steps in collaboration with OHR to ensure that corrective action is taken.

I look forward to the release of budget support funds by the Ambassador so that subject activity can continue. I would like to thank you and your auditors for your cooperative spirit. I welcome them back as soon as possible to continue their essential review of the financial stabilization activity.

Drafted by: CONT:RPJacobs



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