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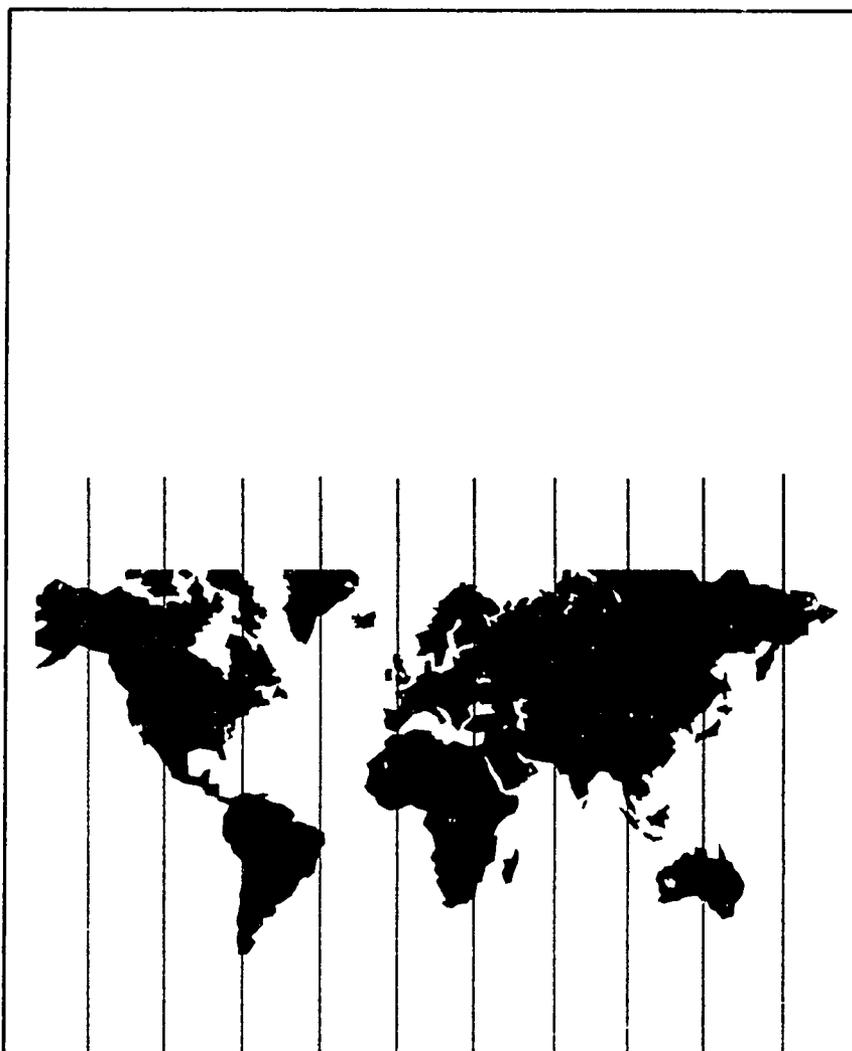
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UNITED STATES  
AGENCY FOR INTERNATIONAL DEVELOPMENT

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THE  
INSPECTOR  
GENERAL



Regional Inspector General for Audit  
CAIRO

AN AUDIT OF  
ALEXANDRIA SEWERAGE TOP PRIORITY PROJECTS

AID LOAN AGREEMENT NO. 263-K-044

AUDIT REPORT NO. 6-263-81-10

JUNE 15, 1981

The city of Alexandria has serious wastewater collection and disposal problems created by rapid population and industrial growth. A Master Plan was financed earlier by the Agency. This plan identified certain problems which needed to be addressed on a top priority basis. These are being addressed by this project. Loan 044 makes available \$15.0 million and the GOE will contribute over LE 44 million for this project. A follow-on grant, amounting to \$167.0 million, will address other parts of the Alexandria Sewerage System.

We concluded that the majority of the objectives of this project are being accomplished and believe this will be a successful project. The USAID/E personnel are exceptionally knowledgeable of project progress and maintain an intensive monitoring program. However, several areas do need the attention of the USAID/E and the General Counsel:

- . There is a need to implement the primary objective of the project. No viable alternative plan has been developed to collect and dispose of solid (excluded) wastes or to enforce the pertinent law.
- . The propriety of paying Contractors a "Special Area Allowance" (which resembles payment of Federal Income Tax) need to be examined by General Counsel.
- . The practice of reimbursing for procurement services on the basis of percentage of costs also needs re-examination; the practice is not sound and may be illegal.
- . The Consultant was unable to support claims for depreciation of vehicles.
- . The Consultant also had insufficient information to support claims for air travel.
- . There were certain payments related to excess baggage charges which were made in error and should be recovered from the Consultant.

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## EXECUTIVE SUMMARY

### Introduction

The city of Alexandria is the principal seaport of Egypt and a summer resort for the Egyptian population. It is located on a narrow strip of land between the Mediterranean Sea and Lake Mariout. The number of permanent residents is well over 2.0 million; these number increase by 1.0 million during the summer months. The rapid population and industrial growth of the city has posed a serious wastewater collection and disposal problem. Briefly, the sewerage system collects refuse, large amounts of raw industrial wastewaters, etc. and discharges it, virtually untreated, into the Mediterranean Sea and Lake Mariout, thereby polluting the beaches and the food chain.

To assist the GOE in its efforts to address this problem, AID began to provide assistance in 1976 for the Alexandria Sewerage System. The first grant provided funding for the employment of a consulting engineering firm to develop a Master Plan for the Alexandria Wastewater Facilities Development Programs. This Master Plan identified certain problem areas in the Alexandria Sewerage System which urgently needed to be addressed or corrected, regardless of the final decision taken on the Master Plan.

It was for the purpose of addressing these "Alexandria Sewerage Top Priority Projects" that Loan No. 263-K-044, for \$15.0 million, was signed between AID and the Egyptian General Organization for Sewerage and Sanitary Drainage (GOSSD). For its part, the Government of Egypt (GOE) agreed to contribute at least LE 44.0 million (about US \$62.9 million).

The Loan Agreement provides that the major element of the Project will include (1) the establishment of improved collection and disposal system for solid wastes and toxic materials, together with the cleaning of existing sewers; (2) the repair and replacement of sewer lines now in disrepair; and (3) the extension of sewer service into the Ras El Soda Area, an urbanization which had no such services at the time.

To implement the provisions of the Loan Agreement, GOSSD and Camp Dresser and McKee, Inc. (Consultant) entered into a host-country contract on February 21, 1978, for consulting engineering services. The Consultant was to provide his service for work on areas identified in the Loan Agreement which under the contract were termed the Alexandria Sewerage Top Priority Projects (Project).

As of March 31, 1981 loan expenditures totaled about \$5.3 million.

### Audit Purpose and Scope

This was the first audit of this project. It is a full-scope audit and was made for the purpose of: (a) assessing the Project accomplishments in relationship with selected Project objectives; (b) evaluating the Consultant's performance regarding certain of the contract requirements; and (c) verifying the propriety of selected items and types of Project funded expenditures.

To accomplish the audit objectives, we: (a) reviewed all pertinent files and records; (b) examined in detail supporting documentation for selected expenditures; (c) visited all Project construction sites; (d) discussed Project activities with pertinent officials; and (e) took such other steps considered necessary under the circumstances.

### Conclusions

Based on our review, we concluded that the majority of the objectives of Alexandria Sewerage Top Priority Project are being successfully accomplished with one exception. If the problems related to solid (excluded) waste (trash, voluminous cow manure, oil, toxic material, etc.) can be solved, we believe this will be a successful project and that it will contribute towards the resolution of problems associated with the sewerage system of Alexandria. One principal reason that accounts for this favorable impression is that the USAID/Egypt personnel involved with this project are exceptionally knowledgeable on all aspects of current and on-going project activities. The Mission also maintains an intensive monitoring program on the Alexandria wastewater activities. We did note several areas which require the attention of the USAID/Egypt and the AID General Counsel. These are stated below.

#### There is a need to implement the primary objective of the project

For at least the past decade, the Alexandria sewerage system has been abused by people dumping into it great masses of materials--solid wastes, voluminous cow manure, trash, mazout, used oil, toxic materials, low pH wastes, septage etc.--which the system was not designed to carry. This practice has greatly reduced the efficiency of the sewerage system. There are laws on the books (Sewer Use Law) which prohibit placing the excluded wastes into the sewers and provided penalties for the improper disposal of the excluded wastes. However, these currently are no viable alternative means for the disposal of the excluded wastes and therefore no realistic basis to enforce the sewer use laws. Accordingly, the primary purpose of the Top Priority Projects, as stated in the Loan Agreement, is (a) to develop and implement a viable collection and disposal system and then in turn (b) to enforce the sewer use laws.

This primary objectives has not been achieved to date and no work towards accomplishing it has taken place since June 1980. Since AID will be providing an additional \$167 million in grant funds (Grant No. 263-0100) it is essential that this objective can be achieved under the current project (page 8).

The propriety of paying Contractors a "Special Area Allowance" must be examined by General Counsel

The contract includes a provision authorizing the payment--up to a maximum of \$73,500--for "Special Area Allowances." To-date, the USAID/Egypt has approved disbursements totalling \$35,000 for this purpose. The concept of paying such an allowance came about as a results of a radical change made by the 1976 Tax Reform Act and appears to represent a reimbursement to the Consultant for U.S. Federal Tax. Several other contracts financed with Agency funds include a provision for Special Area Allowances. Payment of U.S. Federal Income Tax is identified explicitly as an unallowable cost in the AID Procurement Regulations and AID Handbooks on host-country contracting. We believe the propriety of this practice should be determined by the AID General Counsel (page 11).

The practice of reimbursing for procurement services on the basis of percentage of costs needs re-examination

According to the contract, as originally written, the Consultant was to provide AGOSD assistance in procurement of certain commodities. The contract was amended in January 1980, and a provision in the budget was added to provide the Consultant 5 percent-of-cost fee on certain of the commodities they were to assist in purchasing. The estimated budgeted amount of this fee was about \$20,000. To-date, the Consultant has billed AGOSD \$3,389 for this service. AGOSD and USAID/Egypt have approved and paid only \$1,762 to the Consultant for the purchasing fee. The payment of such a fee is a questionable practice which has been discontinued by USAID/E. But, AID/W should provide guidance for the future (page 18).

The Consultant was unable to support claims for depreciation of vehicles

The Consultant has received about \$50,000 of AID project funds in payment for depreciation on vehicles. The Consultant did not have documentation in Egypt to support the claims for these charges. Moreover, there were indications that these depreciation charges were based on vehicles which were originally purchased through previously Agency financed contracts. The Consultant should either submit the required documentation in support for the depreciation charges or refund the amount claimed (page 20).

The Consultant had insufficient information to support claims for air travel

The Consultant does not have sufficient records to properly support payments totaling about \$200,000 for international air travel. The Consultant must support those payments or refund to AID the entire amount paid (page 23).

Erroneous payments for excess baggage charges need to be recovered

USAID/Egypt and AGOSD have erroneously approved dollar payments totaling about \$5,000 for accompanied excess baggage charges on air travel. This amount should be recovered from the Consultant (page 24).

Recommendations

This report contains 8 recommendations for USAID/Egypt or AID/Washington. The recommendations are included in related sections of the report and are listed in Exhibit A.

## INTRODUCTION

### 1. Background

Alexandria is the principal seaport of Egypt. The city is situated on a narrow strip of land between the Mediterranean Sea and Lake Mariout, about 175 Km. northwest of Cairo. The city is built on a elongated land-mass which runs in the northeast southwest direction. A ridge which reaches 14 to 15 meters above sea level, parallels the coast and divides the city in the northsouth direction. The division resulting from this ridge has approximately 80 percent of the landmass sloping toward the sea and 20 percent sloping inland.

There is a natural depression which lies south of the city and is known as Lake Mariout. The level of the lake is controlled, for agricultural purposes, by a series of drains. Waters which seep into these drains from the lake are then pumped into the sea. The lake is very shallow. Its bottom ranges from 2.5 to 3 meters below sea level with a maximum depth of water of about 70 centimeters. Untreated domestic and industrial sewage is now discharged into the lake.

The city serves as the principal summer resort for Egypt. Industries include cotton ginning, cottonseed oil, leather tanning, metal works, paper, soap, matches, shoes, clothing, cigarettes and foodstuffs.

The population of Alexandria has been increasing at a rapid rate. By early 1970, the number of permanent residents had grown to more than 2,000,000. During the summer months, the influx of visitors increase the population by more than 1,000,000.

The rapid population and industrial growth of Alexandria has posed a serious wastewater collection and disposal problem. This problem will be compounded unless improvements to the existing system, combined with the implementation of additional sewerage facilities are carried out to keep pace with the expansion of the city.

The discharge of raw industrial wastewater into the sewerage system, Lake Mariout and the sea is a serious problem. At present virtually none of the industrial wastewaters are pretreated prior to their disposal.

The existing sewerage system of Alexandria is a conventional gravity combined system with 34 pump stations and one treatment plant in service. The system consists of three independent sub-systems, the Central, West and East Zone sub-systems. The Central Zone sub-system discharges untreated wastewater to the Mediterranean Sea at Kait Bay through a 1250 mm pipeline 735 m long. The West Zone sub-system discharges untreated wastewater into Lake Mariout and into the Western Harbor. The Western half of the East Zone sub-system discharges raw wastewater and groundwater drainage into the Hydrodrome drain which discharges in turn to the Kaala Drain and Lake Mariout.

The Eastern half is pumped to the East Treatment Plant where a portion is given primary treatment, another portion is given a poor secondary treatment and a third portion bypasses the plant. Treatment afforded is poor. The wastewaters of Alexandria are relatively very strong and contain a significant industrial wastes load, a portion of which is toxic, and inordinate amounts of trash, garbage and solid wastes, sand, used oil and mazout and cow manure. A second treatment plant in the West Zone is under construction but commissioning of this plant is several years away.

All surface waters in the vicinity of Alexandria receive wastewater discharges. The Mediterranean Sea receives the continuous Kait Bay discharge and significant overflow discharges from the Eastern shore pump stations, especially in the nine months' tourist off-season. Abu-Kir Bay receives a substantial and continuous discharge from the paper mills at Tabia and other discharges from textile mills and developed areas in South-East Alexandria. Lake Mariout receives a tremendous load of raw waste from the Alexandria discharges and much agricultural drainage from the North-West Delta. Raw industrial and domestic wastes are discharged into Western Harbor along its developed shoreline. Lake Mariout contains gross amounts of nutrients and therefore is dystrophic and will in a matter of few decades become a marsh and in succession a peat bog. It can be safely said that no natural waters near Alexandria have been spared substantial pollution from discharges emanating from the city.

In general, the existing collection system is properly designed and there is no doubt its further use is the only acceptable economic alternative. However, many of the sewers are clogged with solids, there are sewers known to have collapsed and there are places where capacity is not great enough. There are also residential areas that have been built over the years that are as yet unsewered. The more significant of these areas is Ras El Soda (70,000 people). In addition, there are operating policies which require correction in order to have a properly operating system. For example, the existing sewer use law must be enforced to exclude discharges which damage the sewers and down-stream facilities and which make proper operation impossible. The surcharged operation of the gravity system must be changed to make use of the solids carrying ability of the gravity-flowing water to decrease sewer clogging. Maintenance functions must be staffed and equipped at a level which will maintain pace with the needs.

To assist the GOE in their efforts to improve the sewerage system in Alexandria, AID provided grant financing for an Agreement dated November 4, 1976, between Camp Dresser and McKee International, Inc. (CDM) and the Government of Egypt (GOE) Ministry of Housing and Reconstruction (MOHR). That Agreement required CDM to provide consulting engineering services on the Alexandria Wastewater Facilities Development Programs (Master Plan).

Prior to completion, the Master Plan Project identified certain problem areas in the Alexandria sewerage system that urgently needed to be corrected or addressed. These activities would be required for the sewerage system no matter what the composition of the final Master Plan. Accordingly, these activities could be undertaken immediately and thereby provide both current and long-term benefits to the citizens of Alexandria.

AID and the GOE agreed to undertake work on certain of the areas of immediate concern. To assist the GOE in this endeavour, AID in September 1977 loaned the GOE \$15 million. The funds were provided through Loan Agreement 263-K-044. The Agreement was between AID and the Egyptian General Organization for Sewerage and Sanitary Drainage (GOSSD).

The GOE agreed to provide no less than 43.9 million Egyptian Pounds (LE) of resources in support for the Loan Agreement activities.

The Loan Agreement provides that the major element of the Project will include (1) the establishment of improved collection and disposal system for solid wastes and toxic materials, together with the cleaning of existing sewers; (2) the repair and replacement of sewer lines now in disrepair; and, (3) the extension of sewer service into the Ras El Soda Area presently unsewered.

To implement the provisions of the Loan Agreement, GOSSD and Camp Dresser and McKee, Inc. (Consultant) entered into a host-country contract on February 21, 1978, for consulting engineering services. The Consultant was to provide his service for work on areas identified in the Loan Agreement which under the contract were termed the Alexandria Sewerage Top Priority Projects (Project).

The scope of work in the Project Agreement, specified that the Consultant's tasks would include the following:

(a) Advice and assistance to GOSSD in relation to:

- the implementation by GOSSD of a recommended sewer use law;
- the establishment of GOSSD organization to collect and dispose of solid and liquid waste material such as mazout, used oil, cow manure, toxic wastes and solids removed from the sewer as a result of sewer cleaning operations (excluded wastes);
- the expansion, reorganization and equipping of the GOSSD sewer cleaning operation to provide adequately for ongoing maintenance; and
- the procurement of equipment for the present GOSSD maintenance and operations department (including spare parts).

(b) The necessary studies, surveys, design and preparation of design drawings, contract documents and estimates of construction costs for:

- the cleaning and inspection of selected sewers;
- the reconstruction of collapsed sewers and sewers identified by inspection to be in need of repair;

- the modification of portions of existing manhole structures as needed to facilitate sewer cleaning;
- the rehabilitation of East Zone pump stations;
- the construction of a relief sewer for the Collector General sewer, a relief storm drain for Mohamed Ali Square and a stormwater drain for the Smouha Area;
- the construction of facilities, including diversion structures, sewers, pump station and force main, to eliminate specified discharges to the Western Harbor;
- the replacement of Sporting Pump Station;
- the extension of the Sporting force main; and
- the construction of sewerage facilities for the Ras El Soda area.

(c) Training of GOSSD personnel.

(d) Advice and assistance to GOSSD in preparing information for tenderers, evaluation of equipment tenders, prequalification of tenderers and awarding of contracts for equipment to be purchased by GOSSD.

(e) Assistance to GOSSD in the general and resident inspection services during the performance of the sewer cleaning and inspection work to be carried out under contract, and/or by GOSSD's Maintenance and Operations Department.

(f) Advice and assistance to GOSSD in the management of the construction and procurement program.

(g) General and inspection services during construction of the facilities listed in item b above to the extent mutually agreed between GOSSD and the Consultant.

The President of the Arab Republic of Egypt issued Decree No. 363 on August 21, 1979. That decree transferred GOSSD responsibilities for Alexandria to the Alexandria General Organization for Sanitary Drainage (AGOSD). Accordingly, Amendment No. 1, to the Agreement for the Project, transferring the Project implementation responsibilities to AGOSD was signed on December 3, 1979.

AGOSD and the Consultant signed Amendment No. 2 to the Agreement on January 7, 1980. That amendment (a) increased the scope of work under the Agreement to cover certain preliminary work under the follow-on Project (Alexandria Wastewater System Expansion); i.e., the final design and preparation of contract documents and estimates of construction of sewerage facilities for Ras El Soda Phase IV and (b) authorized the provision of sewer construction advisory services by the Consultant for the following components of the Project:

- (1) Ras El Soda Collector
- (2) Ras El Soda Services (Phases I, II, III and IV)
- (3) Replacement of Madras Collector
- (4) Replacement of Mostafa Kamel Collector
- (5) Replacement of Caied Gohar Collector

The financial status of the Loan Agreement as of March 31, 1981 follows:

	<u>Obligated</u>	<u>Sub- Obligated</u>	<u>Accrued Expenditure</u>	(\$000) <u>Remaining Balance</u>
- Agreement signed on 9/29/1977	\$ 15,000			
- Letter of Commitment No. 263-K-04401 in favor of C.D.M. Consultant	_____ ,	\$ 6,644	\$ 5,281	\$ 9,719
Total	\$ 15,000 =====	\$ 6,644 =====	\$ 5,281 =====	\$ 9,719 =====

## 2. Purpose and Scope

This is the first audit by the Office of the Regional Inspector General for Audit in Cairo (RIG/A/C) of the Alexandria Sewerage TOP Priority Projects. It is a full-scope audit. Our examination covered the period from Project inception through March 31, 1981 and was made for the purpose of: (a) assessing the Project accomplishments in relationship with selected Project objectives; (b) evaluating the Consultant's performance regarding certain of the contract requirements; and (c) verifying the propriety of selected items and types of Project-funded expenditures.

To accomplish our purpose, we (a) reviewed pertinent files in the offices of the USAID/Egypt, the Consultant in Alexandria and AGOSD; (b) reviewed selected items from reimbursement vouchers maintained by USAID/Egypt and examined the supporting documentation maintained in AGOSD and the Consultant's Alexandria office; (c) visited the construction sites of the Madras, Mostafa Kamel and Caied Gohar collectors; (d) visited the Ras El Soda area and observed the various items of Project activities there; (e) discussed Project activities with officials of the Consultant, AGOSD and USAID/Egypt; and (f) took such other steps as considered necessary under the circumstances.

### 3. USAID/E Comments

The conclusion of our audit were discussed with USAID/Egypt management project staff on May 7, 1981 and the draft audit report was submitted for comments before issuance. All comments received from the USAID/Egypt were considered in finalizing this report.

## AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

### 1. Project Accomplishments

Major Project objectives are being successfully accomplished in the Alexandria Sewerage Top Priority Project with one exception which is discussed later in this report. Many project areas have been completed and the remaining categories of work are proceeding although at a slower than planned pace.

The major achievements of this Project include: (a) complete designs and IFBs for eleven major construction projects; (b) awards of five construction contracts valued at over LE 8 million; (c) construction starts on four projects; and, (d) orders placed for about \$2.6 million of sewer cleaning and maintenance equipment.

Construction on the major Madras, Mostafa Kamel and Caied Gohar collectors is well underway. Work on providing the original sewage system to the Ras El Soda Area is progressing satisfactorily. Major improvement in that section is apparent when compared to two years ago when raw sewage was running in the streets.

Although many problems with implementing the Project are evident, their solutions are technical and very complex. For example, the construction of the collectors is behind schedule. However, the delays are due to the following: (a) incomplete or inaccurate maps of underground utility items (water, sewage pipes, electrical lines, etc.); (b) a major political decision to change the implementing Egyptian Organization (changed from GOSSD to AGOSD) responsible for the project; (c) a lack of experience, on the part of AGOSD, to implement this type of project; and (d) a lack of cooperation between the different "utilities" organizations. Some of these problems have not been resolved. However, we found that most were well known; they had been documented, and their importance understood by the Consultant, USAID/Egypt and AGOSD. Action was being taken by the parties on all of the problem areas we reviewed.

We also found that the USAID/Egypt personnel involved in this Project were exceptionally knowledgeable about all aspects of the current and on-going Project activities. Although this is a host-country contract, the Mission currently maintains an intense monitoring program on all aspects of the Alexandria Wastewater activities including the Top Priority Projects. The few areas we are suggesting changes in or corrective actions on are basically technical financial items which are normally found only through auditing steps.

On the basis of our examination, we believe that the project is contributing significantly toward the resolution of the problems associated with Alexandria's Sewerage System. If the condition addressed by our Recommendation No. 1 is satisfactorily resolved, we also feel this will be a successful project.

## 2. The Primary Project Purpose

For at least the past decade, the Alexandria sewerage system has been abused by people dumping into it great masses of materials--solid wastes, voluminous cow manure, trash, mazout, used oil, toxic materials, low pH wastes, septage, etc. (hereafter referred as "solid (excluded) wastes")--which the system was not designed to carry. This practice has greatly reduced the efficiency of the sewerage system. There are laws on the books (sewer use laws) which prohibit placing the excluded wastes into the sewers and provide penalties for the improper disposal of the excluded wastes. However, there currently is no viable alternative means for the disposal of the excluded wastes and therefore no realistic basis to enforce the sewer use laws. Accordingly, the primary purpose of the Top Priority Projects, as stated in the Loan Agreement, is (a) to develop and implement a viable collection and disposal system and (b) subsequently enforce the sewer use laws.

The primary purpose has not been achieved to date and no work towards accomplishing it has taken place since June 1980. Since AID will be providing an additional \$167 million in grant funds (Grant No. 263-0100) to implement the master plans on the Alexandria Expanded Sewerage System Project, we believe it is crucial that the primary purpose of the Top Priority Project be accomplished as soon as possible.

Section III B of the Project Paper provides the justification for the Project. In that Section it is pointed out that certain areas in the developing master plan on Alexandria's overall wastewater system could and should be started immediately. "The first of which is a solid waste collection and disposal system."

The solid waste collection and disposal system is discussed in detail in the Project Paper under Section IV A. That Section shows that at the present time, and for at least the past decade, the Alexandria sewer system has been grossly abused by the dumping into it of great masses of solid (excluded) wastes which the system is not designed to carry. The solid wastes, septage and cow manure in the volumes discharged to the sewers cannot be carried in the sewer and this results in blockage of the sewer and the accumulation, in addition, of the solids that normally would be carried by the flow in the sewer. The mazout and waste oil float on the water and accumulate in the high points in the system. These materials seriously affect the operation of the treatment plant, make sewer cleaning difficult and potentially dangerous and, upon discharge, degrade water quality and represent a potential fire hazard. The toxics and pH affect the structure of the sewer and any metallic components, and render impossible the operation of any biological treatment processes. The toxics also add materials which may have serious consequences on public health by contamination of the food chain, especially in Lake Mariout fish. In order for the sewers to operate properly, these materials must be kept out. The present Sewer Use Law prohibits the placing of them in the sewer but this law is not enforced. Before this law can be enforced, alternative means of collection and disposal of these wastes must be established and placed in operation and the people who generate these wastes instructed in the proper use of the collection procedures and facilities. The AGOSD's vehicle fleet has been considered as an alternative, but it is too small and most units are not designed to handle the problem wastes.

The Project Paper states that to address this problem, an improved solid waste management system for Alexandria will be developed and implemented. The facilities required will be (1) depots for collection of each of these wastes, (2) facilities for proper disposal of these wastes and (3) vehicles and crews for collection of these wastes and transport to the disposal point. Mazout and used oil and grease should be collected regularly by crews of employees provided with tank trucks and hauled to a remote site for burning. Manure should be similarly collected and hauled to a rural site where farmers could obtain it for their agricultural use. Toxic materials should be separated and concentrated at the industrial plant prior to collection by AGOSD provided trucks for transport to a remote site for lagooning and disposal by evaporation. Regular routes for collecting should be established and facilities provided for storage of the wastes between regularly scheduled pickups. The alternatives to this method of collection and disposal are to contract for private collection and disposal or to require the industry, establishment or individual to dispose, by the best means available, of his wastes. The latter will be impractical because it will result in these wastes continuing to be dumped in the sewer. Another source of solid wastes that will be handled and disposed of is the material taken from the sewers by the sewer cleaning operations. This is noxious material having considerable danger from the public health standpoint. It is expected that a sanitary landfill will be established outside of the urban area for disposal of refuse and noxious wastes.

Concurrent with the establishment of an improved solid waste collection and disposal system, a sewer and pump station wet well cleaning program will be carried out. Once the existing sewers are cleaned and the new solid waste collection system is in place, AGOSD will implement the existing Sewer Use Law (No. 93, of 1962), which provides for penalties for improper disposal of wastes.

It is expected that with implementation of the Sewer Use Law and the assist by contract cleaning of the large sewers, the newly organized and equipped crews will be able to keep up with the sewer cleaning work-load in the future.

The provisions for the solid (excluded) waste aspects of the Project were carried forward to the loan agreement in: (a) Section 2.1 which states: "The Project will include (1) the establishment of an improved collection and disposal system for solid waste and toxic materials, together with the cleaning of existing sewers; ... "; and (b) Section 6.4 of the Special Covenants entitled Sewer Use Law which requires that: "Within one year from the date of this agreement, the Borrower shall develop a plan for the enforcement of the sewer use law, including a system of permits, inspections, tests, and legal procedures.

Loan Agreement 263-K-044 was signed on September 29, 1977. To date, the requirement of Special Covenant 6.4, quoted above, has not been completely fulfilled.

The contract between AGOSD and the Consultant specified the work required on the Sewer Use Law and the solid waste system in Section 2.

Section 2.1.1 was entitled "Implementation of Sewer Use Law" and required the consultant to provide advice, guidance and assistance on the preparation of AGOSD program to implement the sewer use law. This service was to be in two parts. First, the Consultant was to assist AGOSD develop a plan for the achievement of the "objective of the sewer use law and procedures as required by the United States Agency for International Development (USAID) Project Loan Agreement No. 263-K-044." Secondly, the consultant was to assist AGOSD in the implementation of the plan developed in the first part.

The consultant prepared a plan on the first part to implement the sewer use law. However, the plan was not fully acceptable to AGOSD and no efforts have been made to fulfill the second part of Section 2.1.1 requirements to implement the plan on the sewer use law.

Section 2.1.2 of the contract specifies the work requirements for developing and implementing the collection and disposal waste system. The wastes included in the system are those which have in the past and currently are being disposed of by placing in the sewers and drains but which, with the enforcement of the provisions of the sewer use law, will no longer be discharged to the sewers. These wastes include mazout, used oil, toxic liquid and solid wastes, cow manure, septage and solid material taken from sewers in sewer cleaning operations. Specific steps required of the consultant were to: (a) develop a plan to handle and dispose of the waste described above; (b) assist AGOSD in the selection of locations for collection points, transfer stations, depots and disposal sites; (c) design storage facilities to be placed at points of collection, collection vehicles, transfer stations and depots and disposal facilities; (d) prepare the technical specification and contract documents for the construction and/or procurement of the facilities and equipment; and (e) provide overall construction management for the construction of this work.

The consultant developed a limited plan for the system and assisted AGOSD in starting some pilot collection/disposal activities. All of the pilot activities results have been unsatisfactory to AGOSD. Currently, AGOSD pilot activity have been declared unsatisfactory or terminated and no major work is under way to develop the solid waste collection and disposal system. AGOSD told us they hope to do some more work on the sewer use law and solid waste disposal system under Grant 263-0100, the expanded sewerage project for Alexandria.

A review of the progress reports on the Top Priority Projects prepared by the Consultant shows that the contract work category for the sewer use law was officially closed by AGOSD on June 12, 1980. The category for the collection and disposal of wastes has not officially been closed by AGOSD but no activity has been recorded in this category since June 1980.

It appears that over the long period of time (almost 5 years) from development of the Project Paper to date a breakdown in institutional memory has occurred resulting in a current misunderstanding of the importance originally placed on implementing the sewer use law and the collection and disposal of a solid (excluded) waste system.

Given the time frame, the personnel changes in AID, the Consultant and the GOE, the change of GOE implementing agency and the expanding value of AID inputs into Egyptian wastewater and sewerage activities the apparent breakdown in institutional memory is understandable. In our attempts to follow the decision and work processes on the sewer use law and the solid (excluded) waste system we encountered lack of continuity in many areas. This lack of data prevented us from establishing a complete understanding of problems associated with the areas and the basis for closing the work category on the sewer use law. Nevertheless, the Sewer Use Law has not been implemented nor has a collection and disposal of solid (excluded) waste system been developed or implemented.

According to the Project Paper, then: (a) the efficiency of the sewerage system will be greatly reduced without implementation of the sewer use law, and (b) the sewer use law cannot be implemented until the sources developing the solid (excluded) wastes are provided an alternate means to dispose of the wastes. For these reasons, we believe USAID/Egypt should coordinate necessary actions with the GOE, to ensure: (a) development and implementation of a viable collection and disposal of solid (excluded) waste system, and (b) implementation of the sewer use law. USAID/Egypt may accomplish these activities by reinstating the requirements of the Top Priority Projects contract, by amendment to the Alexandria Sewerage Expansion Grant or by any other viable means. But, we strongly recommend that USAID/Egypt take the necessary action to ensure that Alexandria has a viable solid (excluded) waste collection and disposal system and that the sewer use law is implemented prior to completion of the AID-financed Expanded Alexandria Sewerage Project (Grant 263-0100).

#### Recommendation No. 1

USAID/Egypt exert all available management prerogatives to resolve the problems associated with (a) the lack of an Alexandria collection and disposal system for solid (excluded) wastes and (b) implementation of sewer use law.

### 3. Special Area Allowances

The contract includes a provision authorizing the payment--up to a maximum of \$73,500--for "Special Area Allowances." To-date, the USAID/Egypt has approved disbursements totalling \$35,000 for this purpose. The concept of paying such an allowance came about as a results of a radical change made by the 1976 Tax Reform Act and appears to represent a reimbursement to the Consultant for U.S. Federal Tax. Several other contracts financed with Agency funds include a provision for Special Area Allowances. Payment of U.S. Federal Income Tax is identified explicitly as an unallowable cost in the AID Procurement Regulations and AID Handbooks on host-country contracting. We believe the propriety of this practice should be determined by the AID General Counsel.

Amendment No. 2 to the contract was signed by AGOSD and the Consultant on January 7, 1980. That amendment, among other things, added Article 38 to the contract. Article 38 was entitled "Special Area Allowances" and specifies that the allowance represents additional costs, associated with assignment of resident project employees, which were not otherwise provided for under the Agreement. The article also states that the allowances will be subject to equitable adjustment, upward or downward, at the request of either party in the event of any substantial revision to Title 26 U.S.C. Sections 911 or 913. Sections 911 and 913 of the Internal Revenue Code deal with Federal income tax allowance, exemptions, etc. on U.S. citizens working in the private sector overseas.

On November 9, 1980, Amendment No. 3 to the contract was signed. That amendment deleted Article 38 in its entirety, and substituted a new Article 38 also entitled "Special Area Allowances". The new Article 38 retained the same total amount and monthly payment rates for the "Special Area Allowances". But, the amendment expands and specifies the requirements for adjusting the allowance payments. That is, the new Article 38 states:

"The estimated total price for CONSULTANT's Special Area Allowance is \$73,500 and shall be subject to definitization for each calendar year of contract performance within that estimated amount. On or before the last day in January following the end of each calendar year, the CONSULTANT shall submit a substantial analysis to AGOSD and AID of the amount of allowances which were reimbursed to each resident project employee for that year. The Parties agree to a prompt adjustment upward or downward of the allowances previously paid to the CONSULTANT following the submittal and approval by AGOSD and AID of the above analysis. The Special Area Allowances, in addition, shall be subject to equitable adjustment upward or downward, at the request of either party in the event of any substantial revision to Title 26 U.S.C. as it pertains to resident project employees. The Parties agreed to negotiate and establish such equitable adjustments promptly.

"Pending the establishment of definitized prices for Special Area Allowances for calendar years 1980 and 1981, CONSULTANT is authorized to partial payments for such allowance of \$3,500 per month during 1980 and \$2,625 per month during 1981. Upon establishment of such definitized Special Area Allowances for 1980 and 1981, the payments for 1980 and 1981 shall be adjusted upward or downward to reflect the definitized prices. Partial payment rates for succeeding calendar years shall be adjusted upon definitization.

"To the extent applicable, a similar provision shall be included in any subcontracts hereunder."

USAID/Egypt officially approved both Amendment 2 and Amendment 3 to the contract on September 25, 1980.

The question of whether to reimburse contractors for the anticipated increase in U.S. Federal income tax resulted from the Tax Reform Act of 1976 and was addressed by AA/SER in February 1977. AA/SER advised that some contractors had suggested that their salaries under AID-financed contracts should be adjusted upward to compensate for increased taxes on their income. AA/SER answered the tax question stating "That AID take no special measures to offset reduced tax exemptions resulting from the Tax Reform Act of 1976." AA/SER, in discussing that decision on taxes, pointed out that "Firms and Institutions will undoubtedly take the changed tax situation into account when preparing overall compensation plans for proposal to AID, cooperating countries and others for future work overseas. Compensation negotiated or approved by AID should be at minimum level necessary to attract needed talents and services in a competitive market."

Following protracted discussions on the tax changes, the USAID/Egypt Director requested the USAID/Egypt Legal Office to prepare an action memorandum to establish USAID policy on the tax equalization subject for his approval.

On February 18, 1980, the USAID/Egypt Director approved an action memorandum dated February 12, 1980 on the subject "USAID Tax Equalization Policy." Pertinent section of that action memorandum follows:

Problem: To establish Mission policy with respect to compensation of A.I.D.-financed contractors for the cost of additional U.S. taxes on their employees as a result of assignment in Egypt.

Discussion: The 1976 Tax Reform Act reduced the exemption for private U.S. citizens overseas from \$20,000 to \$15,000 and applied a higher tax rate to the employee's net taxable income. 77 AIDTO Circular A-57 (copy attached) referred to A.I.D.-financed contractor/grantee requests for upward salary adjustments to compensate for increased taxes as a result of the Act. In ruling out such adjustments under existing contracts and grants, AID/W noted that "firms and institutions will undoubtedly take the changed tax situation into account when preparing overall compensation plans." The circular then stated "Compensation negotiated or approved by A.I.D. should be at minimum levels necessary to attract needed talents and services in a competitive market."

Although the Foreign Earned Income Act of 1978 eased the burden on overseas contractor employees in some respects, it left them with a continuing responsibility for taxes on such potentially expensive benefits as housing and education. Notwithstanding a vigorous private sector lobbying effort to modify the overseas taxation provisions, contractors and prospective contractors continue to demand relief from USAID/Cairo. We believe that the Mission should distinguish between existing contracts and contracts presently being negotiated.

"In the former case, no relief would be allowed, except in the case of an amendment being negotiated for good and sufficient consideration (e.g., an extension in the contract period or services). This position is not only consistent with the approach in the cited AIDTO Circular and ASPR 15-205.6(a) (1)(copy attached), it also reflects the fact that most A.I.D.-financed contractors in Egypt would have had sufficient notice of the tougher 1976 tax law at the time they negotiated their agreements.

"For new contracts (and for amendments with real consideration), however, we believe that the cited ASPR approach is sound. (Underscoring added). Thus USAID should approve contract costs including salary, at levels necessary to obtain required services, taking into account as appropriate any additional taxes on contractor employees resulting from foreign assignment. This is a common sense policy approach: we don't want A.I.D.-financed contractors to compromise on the quality of personnel assigned to Egypt. For it would be unreasonable to expect a contractor to recruit an employee for overseas duty, if it involved a net decrease in income."

Based on the information contained in the action memorandum, the Mission's position seems to have reasonable basis. However, the action memorandum omits certain pertinent information which should have been considered. When this additional information is taken into account, the basis for paying the Special Area Allowance becomes somewhat tenuous.

The USAID/Egypt repeatedly cites the Armed Services Procurement Regulations (ASPR). However, the applicability of the ASPR's in the case of contracts financed by the Agency is not clear. But in any event, the pertinent section (15-205.6) of the ASPR referred to by the Mission above reads "When the personal services are performed in a foreign country, compensation may also include overseas differential which may properly consider all expense associated with foreign employment such as housing, cost of living adjustments, transportation, bonuses, additional Federal, State, Local or foreign income taxes resulting from foreign assignment and other related expenses. Although the aforementioned additional taxes may be considered in establishing overseas differential, any increased compensation calculated directly on the basis of an employee's specific increase in income taxes is unallowable."

Based on the ASPR regulations it appears that the contracting party may provide the contractor an overseas differential and that differential is paid in consideration of additional expenses associated with foreign employment including additional U.S. Federal income tax. But, under the ASPR any increased compensation based on increased income taxes is unallowable. The Special Area Allowance is directly related to specific U.S. Federal income taxes increase and therefore, under the ASPR regulation, an unallowable cost.

The Federal Procurement Regulations (FPRs) are incorporated by reference in the AID Procurement Regulations (AIDPRs) and thereby apply to AID procurement activities.

The FPRs and the ASPRs contents are very similar. In fact, the FPRs were originally derived from the ASPRs and the codification is the same. During our review, we analyzed (a) Section 15.205-6 of the ASPRs, referred to in the Mission policy documents on tax equalization, (b) Section 15.205-6 of the FPRs, and (c) Section 15.205-6 of the AIDPRs. We found that the two pertinent sentences taken by the Mission from the ASPRs and used as the basis for their policy decision on tax equalization were conspicuously absent from the FPRs and AIDPRs. The FPRs and AIDPRs are incorporated into the AID Handbook system as Handbook No. 14. However, the FPRs and AIDPRs do not directly apply to AID-financed host-country contract. But, the procurement and cost principles contained in the FPRs and AIDPRs are the basis for the AID Handbooks which do apply to the Consultant's contract. Therefore, it seems more appropriate to search those documents and regulations that have a closer relationship to the AID Handbooks to find a basis to support a USAID/Egypt policy decision; i.e., the FPRs and the AIDPRs should be used as precedents for formulation of AID policy instead of the ASPRs.

The AID procurement regulations are also coded on the same basis as the FPRs and ASPRs. We found that they authorize a procedure to compensate certain personnel who, because they work overseas, have an increase in U.S. Federal income tax. That is, "Contract employees serving overseas under a contract who do not qualify, request and receive an exemption for overseas income provided under Section 911 of the U.S. Internal Revenue Code (26 U.S.C. 911) are eligible to receive an overseas recruitment incentive, provided that the average incentive for all such employees does not exceed 10 percent of the initial base annual salary of all employees eligible for the incentive under the contract."

The AIDPR Section quoted above would not normally apply because most contractors still request and receive exemption from overseas income for U.S. Federal income tax payments on portions of their income earned overseas.

Other than the exemption discussed above the AIDPR and the FPRs are explicit in Section 15.205-41 that U.S. Federal income taxes are not an allowable cost item.

The principle that the U.S. Government will not directly pay its own income taxes is carried forward to the AID Handbooks. AID Handbook 11 on Host country contracting in its Chapter 4 on Cost Principles under Section 4F entitled unallowable costs states "Certain other costs are of such a nature that they are not normally considered appropriate as allowable or allocable to the direct or indirect (overhead) cost categories as heretofore described. However, these costs may exist as actual expenses of the contractor's organization. Such costs may well be legitimate and even desirable insofar as the contractor is concerned. However, because of their nature these costs are not eligible for allocation as direct or indirect (overhead) costs of the borrower contract within the context of these provisions. Such unallowable costs should either be absorbed by the contractor within his fixed fee or eliminated from being charged to his operations under the borrower contract."

One of the examples of such unallowable cost in that Handbooks Section is U.S. Federal income taxes.

The Special Area Allowance in the Consultants contract is made specifically to compensate resident project employees for increased expenses resulting from the changes in the tax law under Title 26 to U.S.C. Sections 911 and 913. The contract explicitly states further that the allowance shall be subject to equitable adjustment, upward or downward, in the event of any substantial revision to Title 26 U.S.C. as it pertains to resident project employees. Further, each year the amount reimbursed to the employees will be definitized and the allowances adjusted accordingly. Therefore, this allowance is a direct payment for U.S. Federal income taxes and unallowable.

The Mission has expressed concern over this finding because they have incorporated the Special Area Allowance into many contracts and the outcome may have a substantial impact on their program. In responding to our draft audit report, the USAID/Egypt provided the following information or additional support for its position on allowances:

"By way of background, the decision to include such an allowance was not taken lightly. The taxation of employee allowances under Federal tax reform legislation in 1976 and 1978 substantially increased contractor costs. Firms had to assure prospective employees that they would not be worse off financially by accepting a resident position in Egypt and in other high allowance countries. So in various ways they established tax equalization arrangements as part of employee compensation packages. Contractors, in turn, began to demand equalization amounts in their negotiation of contracts in Egypt.

"With the professional assistance of ..... an attorney-advisor in GC/NE and one of AID's most experienced lawyers in federal government contracting, we developed the special area allowance language cited by the auditors. Three points should be made in its behalf.

"1. THE SPECIAL AREA ALLOWANCE IS NOT A DIRECT REIMBURSEMENT OF FEDERAL INCOME TAXES, BUT RATHER A PAYMENT TO THE CONTRACTOR AS AN EXTRA INDUCEMENT TO PERFORM WORK IN EGYPT DESPITE THE TAXATION OF ALLOWANCES.

"The first thing to note is that a special area allowance ("allowance") is not a reimbursement of contractor employee taxes, prohibited under HB 11 Chapter 4 cost principles, nor does it reflect an upward adjustment of existing contracts to compensate for the tax effect. Rather, it is a negotiated element of compensation to the contractor (at minimum levels necessary) specifically paid to induce contractor performance in Egypt. The allowance formula, despite "definitization" in interim years, does not compensate contractor employee taxes on allowances dollar-for-dollar. Therefore, the allowance should be an allowable expense. Indeed, it simply reflects SER/CM guidance promulgated by AID To Circular A-57, dated February 12, 1977:

'Firms and institutions will undoubtedly take the changed tax situation into account when preparing overall compensation plans for proposal to AID and cooperating countries and others for future work overseas. Compensation negotiated or approved by AID should be at minimum to attract needed talents and services in a competitive market.' (emphasis added)

"The bottom line is clear: absence such an allowance or additional fee to compensate for the tax impact, USAID would not be able to attract qualified U.S. firms to carry out its program in Egypt. The question then becomes not whether contractor employee tax equalization should be compensated, but how.

"2. THE SPECIAL AREA ALLOWANCE APPROACH WAS IN THE BEST INTERESTS OF THE U.S. GOVERNMENT, TAKING INTO ACCOUNT THE SIZE OF THE COMPENSATION REQUIRED AND THE GREAT UNCERTAINTY SURROUNDING THE RELEVANT TAX CODE PROVISIONS.

"The easy path would have been to bury tax equalization in fee. In fee weighting formulas, for example, an extra point could have been attributed to the tax factor. As those of us involved recognized at the time, the fee solution would also have avoided future audit inquiry. But in my view, this would have been an imprudent approach, creating the potential for an enormous contractor windfall. Instead, we established in the special area allowance a sound way of limiting compensation to the minimum amount necessary and cutting it off if and when the taxation of allowances is discontinued (as reports suggest it will soon be discontinued). Thus, we believe that the allowance approach was and is in the best interest of the U.S. Government.

"3. THE "OVERSEAS RECRUITMENT INCENTIVE" PERMITTED FOR AID DIRECT CONTRACTS SUPPORTS THE SPECIAL AREA ALLOWANCE IN HOST COUNTRY CONTRACTS BY ANALOGY.

"The overseas recruitment incentive permitted in the AIDPR does not, as the draft audit report suggests, rule out the special area allowance. To the contrary, it provides an intellectual basis for the allowance approach. AIDPR Sec. 7-15-205.6 (a) (3) deals with the exemption from overseas income (i.e., the 510 day rule) rather than the taxation of allowances imposed by the 1976 and 1978 amendments to Sections 911-13 of the Internal Revenue Code. But it incorporates the two elements which are central to the special area allowance: specific identification with the tax impact on contractor employees (as opposed to simply enlarging fee) and a cut-off provision (i.e., right of refund if employees become eligible for exemption from overseas income).

Because of the importance of this issue, we welcome Agency-wide consideration of the special area allowance. It is, however, important to recognize existing contractual rights which would appear to foreclose any refunds of allowances already negotiated, paid and received in good faith. Furthermore, for the reasons stated above, it is in my view entirely proper for USAID/Cairo to continue to include special area allowance clauses in future contracts until such time as higher authorities may rule them improper."

Since the decisions resulting from this finding may also affect several other projects we are directing the recommendations related to the Special Area Allowances to AID's General Counsel for resolution.

Recommendation No. 2

AID General Counsel determine the propriety of the Special Area Allowances payments to the Consultant.

Recommendation No. 3

USAID/Egypt take any necessary action to implement the General Counsel's determinations resulting from Recommendation No. 2.

4. Purchasing Services as a Percentage-of-Cost Direct Charge

According to the contract, as originally written, the Consultant was to provide AGOSD assistance in procurement of certain commodities. The contract was amended in January 1980, and a provision in the budget was added to provide the Consultant 5 percent-of-cost fee on certain of the commodities they were to assist in purchasing. The estimated budgeted amount of this fee was about \$20,000. To-date, the Consultant has billed AGOSD \$3,389 for this service. AGOSD and USAID/Egypt have approved and paid only \$1,762 to the Consultant for the purchasing fee. The payment of such a fee is a questionable practice which has been discontinued by the USAID/E. But, AID/W should provide guidance for the future.

The purchasing fee is questionable on two basis: First, purchasing service is an appropriate item of cost included in the Consultant charges for overhead for overseas office, Home office and for their International Division. Any additional direct costs incurred by the Consultant; e.g., personnel time, telephone, postage, associated with the purchase of the commodities is paid as direct cost under other provisions of the contract. Accordingly, this represents a duplicate payment for the same service. Secondly, this fee violates one of the basic costs principles of sound contracting. That is, it is a cost-plus-a-percentage-of-cost item and thereby provides the Consultant an inherent incentive to pay the highest price for the commodities. This procedure of contracting for services is prohibited by AID Handbooks in the pricing of a contract.

Purchasing services costs are included in the Consultant's overhead charges and the purchasing fee represents, in effect, a duplication of payment. However, the Consultant has a valid contract and provided the required service. Therefore, we cannot appropriately recommend recovery of the payments. But, we believe USAID/Egypt should terminate additional purchases under that provision of the contract. Furthermore, we suggest that USAID/Egypt not enter into A&E contracts which include that type of direct purchasing fee provision.

In responding to our draft report and the two recommendations presented in it (Nos. 6 and 7 at the time), the USAID/Egypt provided us the following comments:

"As to Recommendations 6 and 7 relative to paying a fixed percentage of the cost of purchase of miscellaneous goods, we offer the following for your consideration.

The Mission has already instituted action to discontinue project commodity procurements by the contractor under the arrangement described in the audit report. The Mission has reviewed relevant Agency guidance with respect to the payment of procurement service agents with an eye to the establishment of procedures consistent with Agency policy and government contract procedures. Our conclusion is that more specific Agency guidance is required. Accordingly, the Mission plans to initiate a discussion of the issue with AID/W in order to obtain more definitive guidance. Current rules with respect to the payment for procurement services are found principally in Handbook 18, AID-financed Commodities. Procurements through GSA are assessed a surcharge of eight percent (8%) of the price of the commodity as a compensation for GSA's services (Handbook 18, para 4.C.1.). Other federal agencies assess surcharges which vary from agency to agency (Handbook 18, part 4G). Paragraph 5G, of Handbook 18, which gives guidance regarding commodity procurements by contractors does not, however, treat pricing. However, guidance with respect to the Afro-American Purchasing Center, Inc. (AAPC) requires the inclusion of the following or similar statement in the underlying PTO/C:

'The payment of fees for purchasing commodities authorized by this document are reimbursable at the rate of 7% of the FAS value of transactions or as otherwise agreed by AID and AAPC.'

Given the apparent contradiction between the above examples and the more general contracting policy disfavoring the use of a cost-plus-percentage-of-cost basis for payment, we believe it would be useful to have one recommendation changed to read as follows:

'USAID/Egypt seek guidance from AID/W on the acceptability of various methods of payment under contracts which provide for the procurement of commodities by contractors and that USAID/Egypt establish procedures with respect to this question consistent with the guidance received. Agencywide policy should be clarified as a result of the review of this issue.'

Our draft report contained a Recommendation No. 6 which read "USAID/Egypt should not authorize the Consultant to make additional purchases that require direct fee payments for purchasing services." As noted above in the Mission comments, the USAID/Egypt took this action prior to issuance of this report. Accordingly, we have eliminated that recommendation from the final report.

We also agree with the Mission that there is a need for AID/W to provide guidance on the acceptability of various methods of payment under the contracts. The recommendation is modified in line with the wording suggested by the USAID/E.

#### Recommendation No. 4

USAID/Egypt (a) seek guidance from AID/W on the acceptability of various methods of payment under contracts which provide for procurement of commodities by contractors, and (b) establish procedures with respect to this question consistent with the guidance received.

#### 5. Depreciation Charge for Vehicles

The Consultant has received about \$50,000 of AID project funds in payment for depreciation on vehicles. The Consultant did not have documentation in Egypt to support the claims for these charges. Moreover, there were indications that these depreciation charges were based on vehicles which were originally purchased through previously Agency financed contracts. The Consultant should either submit the required documentation in support for the depreciation charges or refund the amount claimed.

The contract between the Consultant and AGOSD, as originally written, provided for a unit rate allowance for depreciation on vehicles. The depreciation rate was shown in the Schedule of Estimated Costs incorporated into the contract as Annex V. The estimated depreciation expenses was included in Line Item 15 entitled "Other Direct Costs". Details of items included in "Other Direct Costs" contain brief descriptions (only make and type) of ten vehicles that could be used in the project and depreciated against project funds. The details also specify the number of months each year during the life of the contract that each vehicle could be depreciated and charged to

the contract. The unit rate allowance for the depreciation charge was listed at \$220 a month for all type vehicles. The Annex also showed that a maximum of 10 vehicles could be depreciated during certain months of the contract period.

The second Amendment to the contract was signed by AGOSD and the Consultant on January 7, 1980; this amendment was officially approved by the USAID/Egypt on September 25, 1980. One of the changes resulting from this Amendment was the elimination of estimated depreciation charges for vehicles.

One of the basic principles in a cost reimbursable plus-fixed-fee type contract is that, with the exception of the fee, all costs charged to the contract must be actually incurred and supported.

During our review, we attempted to verify that the vehicles being depreciated and charged against the contract were properly incurred cost. We requested the contractor to provide us with their asset accounts, inventory and assignment records on vehicles and procurement documents related to the purchase of the vehicles being depreciated and charged to the contract.

Officials of the Consultant informed us that:

- . All vehicles, except the ones purchased under this contract, had been turned over to the GOE.
- . The company did not have any documentation in Egypt on the vehicles in question.
- . Possibly the procurement and asset accounts covering the vehicles might be in the Contractor's home office in the United States.

The facts are that the Consultant did not have, in Egypt, the required documentation to support the depreciation claims made against the contract. Without such documentation, the Contractor was unable to support that (a) there were vehicles, (b) the type of vehicles, (c) the source and origin of the vehicles, and (d) the vehicles were assigned to and used solely for the Project. Even if the Consultant did have asset and procurement records in the home office, we cannot see how they could possibly control the assignment and use made of the vehicle; this would have to be done in Egypt.

Nevertheless, we reviewed the depreciation charges with AGOSD to see if they had records to support the charges. AGOSD did not have records to properly support the charges or to connect the assets to the depreciation charges. But, AGOSD did have documents showing that the Consultant under letterhead from the Top Priority Project, had returned 12 vehicles to the GOE. One of the vehicles had been destroyed and one was of non-U.S. manufacture. The 10 remaining vehicles were of appropriate U.S. make and type to closely approximate the brief descriptions of the vehicles listed in the contract for depreciation purposes. One document further stated that those vehicles the Consultant returned to AGOSD had been purchased with AID funds. Another document stated that the vehicles were purchased under the AID/Alexandria Water and Wastewater Agreements.

We briefly reviewed the consultant agreements for the Alexandria Water and Alexandria Wastewater Project to verify the vehicle procurement. However, both of those contracts were lump-sum payment contracts and each of the contracts contained a clause prohibiting our audit. Accordingly, no further audit steps were undertaken.

Based on the information obtained from AGOSD, it appears that any vehicles the Consultant depreciated and charged to this AID-financed contract, were vehicles that had been financed under other AID-financed contracts. But, due to inadequate records, we cannot conclusively establish which or if any vehicles could be properly depreciated against this contract.

Of the unsupported charges paid the Consultant for depreciation on vehicles, we found that a total of \$3,520 was made for the period of time subsequent to the USAID/Egypt approval of the January 1980 Amendment to the contract that terminated the provision allowing vehicle depreciation under this Project.

Since the Consultant could not provide minimal supporting documentation to show that they provided appropriate vehicles and used them solely for project purposes, we must recommend that AID have the Consultant (a) develop acceptable supporting documentation for the payments or (b) refund the amounts paid for unsupported depreciation charges on vehicles (about \$49,280 total).

Recommendation No. 5

USAID/Egypt collect \$3,520 erroneously paid for depreciation expenses subsequent to approval of the January 1980 Amendment which terminated authorization for payments of depreciation expenses.

Recommendation No. 6

USAID/Egypt require the Consultant to (a) provide acceptable supporting documentation for the depreciation expense payments or (b) refund any amounts that are not properly supported.

## 6. Preference for United States Flag Air Carriers

The Consultant does not have sufficient records to properly support payments totaling about \$200,000 for international air travel. The consultant must support those payments or refund the entire amount paid to AID.

The contract incorporates the requirements of Public Law 93-623 into the Agreement in Article 25. That Public Law requires the consultant to use U.S. flag air carriers for international air transportation of personnel and their personal effects or property to the extent service by such carriers is available.

Article 12 of the contract requires the consultant to maintain books, records, documents and other evidence and accounting procedures and practice sufficient to reflect properly all transactions under or in connection with the Agreement.

We reviewed the Consultant's billing for international air travel. Initially, the Consultant provided a copy of the passenger's coupons for the issued air tickets. The passenger's coupons showed: (1) many questionable uses of non-U.S. flag air carriers; (2) tickets that were issued with part or all segments of the travel open; and (3) unusual travel routes. We attempted to establish the actual travel performed, but we were told that the Consultant's personnel do not submit travel voucher or the equivalent for their travel.

Late in 1978, the Consultant changed the type of documentation submitted to support the billing for international air travel. The Consultant now only provides a copy of the billing from their travel agency to support the billings for international air travel expenses. These billings do not show which airlines were actually used to incur the travel expenses charged to the contact.

With only the limited records and documentation provided by the Consultant, the propriety of payments for international air travel cannot be determined. Accordingly, we are recommending that USAID/Egypt require the Consultant to provide proper documentation or refunds for all payments made for international air travel (about \$200,000).

### Recommendation No. 7

USAID/Egypt obtain (a) a refund from the Consultant for unsupported payments made for international air travel or (b) sufficient documentation to verify that the actual travel performed was allowable under terms of the contract.

## 7. Unallowed Dollar Payments

USAID/Egypt and AGOSD have erroneously approved dollar payments totaling about \$5,000 for accompanied excess baggage charges on air travel. This amount should be recovered from the Consultant.

The contract as originally written and as amended provided that excess baggage charges for return travel from Cairo be paid for only with Egyptian Pounds. However, we found that payments for excess baggage on some return trips were made in U.S. Dollars. The contract requires the GOE to provide funding for all Egyptian pound provisions of the contract. Accordingly, the return travel excess baggage charges paid with AID-provided U.S. Dollars were made in error and should be refunded. The Consultant can then claim Egyptian Pound payments from AGOSD for the excess baggage charges.

### Recommendation No. 8

USAID/Egypt determine and recover the amount of U.S. dollar payments made to the Consultant for return-travel excess baggage charges.

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USAID/Egypt require the Consultant to (a) provide acceptable supporting documentation for the depreciation expense payments or (b) refund any amounts that are not properly supported.	

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USAID/Egypt obtain (a) a refund from the Consultant for unsupported payments made for international air travel or (b) sufficient documentation to verify that the actual travel performed was allowable under terms of the contract.

Recommendation No. 8

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USAID/Egypt determine and recover the amount of U.S. dollar payments made to the Consultant for return-travel excess baggage charges.

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<u>USAID/Egypt</u>	
Director	5
Regional Inspector General for Investigations & Inspections (RIG/II/C)	1
<u>AID/Washington</u>	
AID Deputy Administrator	1
Assistant Administrator/Bureau for Near East (AA/NE)	5
Office of Egypt/Israel Affairs (Egypt Desk NE/EI)	1
Bureau for Near East (Audit Liaison Officer)	1
Bureau for Near East (Office of Project Development)	1
Office of Legislative Affairs (LEG)	1
Office of the General Counsel (GC)	2
Office of the Financial Management (FM/ASD)	1
Office of Contract Management (SER/CM/SD)	1
Bureau for Development Support (DS/DIU)	4
Office of the Inspector General (IG)	1
Office of Policy, Plans and Programs (IG/PPP)	1
Office of Executive Management Staff (IG/EMS)	12
Office of Investigations and Inspections (IG/II/W)	1
Office of the Regional Inspector General for Audit/Washington (RIG/A/W)	1
<u>Regional Inspectors General for Audit</u>	
RIG/A/Karachi	1
RIG/A/Karachi--New Delhi	1
RIG/A/Manila	1
RIG/A/Nairobi	1
RIG/A/Panama	1
RIG/A/La Paz Residency	1