UNITED STATES
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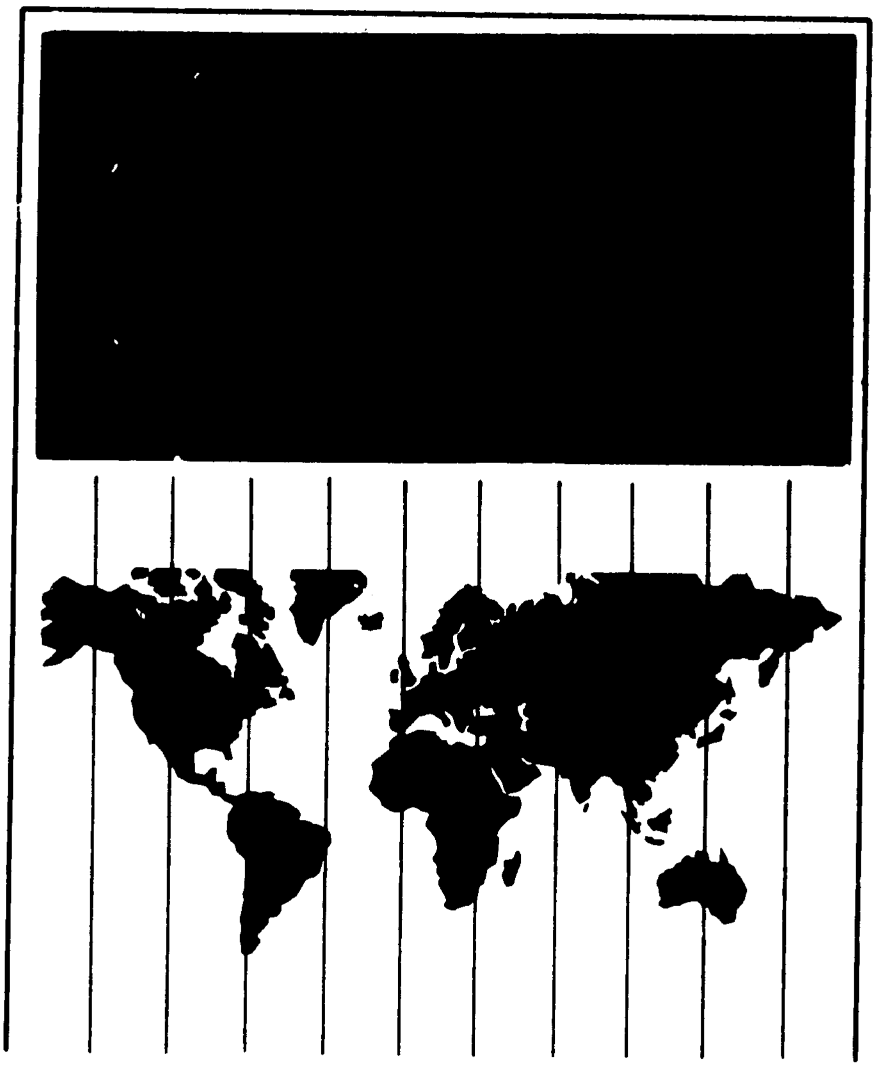
THE INSPECTOR GENERAL



Regional Inspector General for Audit
CAIRO

AUDIT REPORT
ON
AN ASSESSMENT OF AID'S
DEVELOPMENT DECENTRALIZATION-ONE PROJECT
IN EGYPT
PROJECT NO. 263-0021

Audit Report No. 6-263-82-7

Dated July 7, 1982

As early as 1973 AID had been looking for a rural development activity in Egypt that would provide entry at the village level into the rural development sector. AID's $26.2 million Development Decentralization-One Project effective May 29, 1978 was approved to assist the GOE's process of decentralization by strengthening the financial viability and development capability of selected village councils. Some progress has been made in implementing this project:

-- the project's Local Development Fund within the Government of Egypt was established to implement the project;

-- AID disbursed $6.2 million to capitalize the development fund; and

-- a U.S. consultant firm was contracted to provide technical assistance to the project.

Nonetheless, much more needs to be done if AID's project objectives are to be achieved.

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GLOSSARY

AID	Agency for International Development
BVS	Basic Village Services Project
DD-I	Development Decentralization-One Project numbered 263-0021
Executive Council	GOE-appointed representatives of Ministries working in villages to administer the programs of Local Government
GOE	Government of the Arab Republic of Egypt
Governorate	An administrative unit established by Presidential Decree and comprised of a geographical region consisting of a main city (the Capital) and towns, markaz and villages.
HEO	Head Executive Officer--appointed by the GOE to chair the Executive Council
IG	AID's Inspector General
LDF	Local Development Fund: (i) the ORDEV unit created to implement the DD-I project, and (ii) the Fund itself
LE	Egyptian Currency (Pounds) at an official exchange rate of LE0.70 = $1.00
Local Services and Development Fund	Village-level 'special account' from which monies are used to benefit villages as determined by the elected village councils
Markaz	An administrative sub-unit of a governorate established by a Prime Minister's Decree comprising a geographical area consisting of a town which is the Capital of the Markaz and several villages
ORDEV	Organization for Reconstruction and Development of the Egyptian Village
Popularly Elected Village Council	Elected council consisting of 18 members including at least one female

EXECUTIVE SUMMARY

Introduction

During the last decade the Government of the Arab Republic of Egypt (GOE) has emphasized the importance of all governmental levels in the active determination of the economic and political future of Egypt. Administratively the GOE is divided into districts, governorates, markaz, towns and villages. Twenty-one of 25 existing governorates in Egypt have rural areas containing about 147 markaz surrounded by over 4,000 villages. Egypt's overall goal is greater integration of these units into the process of development. In sum a policy of decentralization is being effected by permitting each administrative level to be governed by popularly elected local councils.

As early as 1973 AID had been looking for a rural development activity in Egypt that would provide entry at the village level into the rural development sector. Thus, beginning in January 1976 AID in conjunction with ORDEV* initiated a series of studies designed to identify an activity that met this criteria. The Development Decentralization-One (DD-I) project is one of the results of the studies.

The DD-I project, effective May 29, 1978, is to assist the GOE's process of decentralization by strengthening the financial viability and development capability of selected village councils. The chief component of the DD-I project is a Local Development Fund (LDF) that lends money to village councils for the purposes of establishing income-producing projects. Income generated is recyled into the village-owned Local Services and Development Fund and used for other projects of benefit to the village.

At December 31, 1981, the audit cut-off, AID had obligated $26.2 million and LE150,000 for the project. Disbursements totalled $9.0 million and LE148 thousand. The last $15.0 million of AID's $26.2 million was obligated on August 19, 1981.

Scope

The audit was made to determine if the DD-I project has been implemented in accordance with the requirements of the Project Grant Agreement and in compliance with U.S. and GOE regulations. Appendix I contains an expanded statement of background and audit scope.

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* On July 16, 1973 former President Sadat authorized the creation of a special group under the Ministry of Local Government named the Organization for Reconstruction and Development of the Egyptian Village (ORDEV). Its responsibility was to "Elaborate a general policy and plan for construction and development of the village in the economic, social and urbanization plans within the scope of the general policy of the State."

Summary of Major Findings and Recommendations

Some progress has been made in implementing AID's project to strengthen the financial viability and development capability of selected village councils. In this regard, the project's Local Development Fund was established, AID grant funds were provided to capitalize the Local Development Fund, and a U.S. consultant firm was contracted to provide technical assistance to ORDEV and village councils.

Nonetheless, much more needs to be done in all areas of project management before AID's objective will be achieved. Therefore, we have identified several areas in need of management attention:

- The U.S. contractor, ORDEV-affiliated personnel at the Governorates, and the ORDEV/LDF technical specialists did not effectively monitor the LDF-financed village projects. Less than satisfactory accounting and financial practices, internal controls, and reporting are common problems inherent to LDF village projects. We have made recommendations to assess the management and performance of the U.S. contractor (page 1); to formalize the role of ORDEV-affiliated personnel (page 5); and encourage ORDEV to devote resources to cover field expense of technical specialists (page 6).

- Transfer of AID funds to time deposits slowed disbursement of monies intended for loans to village councils and resulted in increased interest costs to the U.S. Government. We recommend recovery of $217,489 representing interest earned at December 31, 1981. Also, that USAID/E determine and collect interest earned on time deposits from January 1, 1982 (page 7).

- Bonuses and incentives were paid to GOE personnel assigned to work in villages from revenues generated by LDF-financed projects. In our view, Egyptian public law prohibits bonus and incentive payments. We recommend that USAID/E and ORDEV/LDF obtain a decision from the GOE whether or not these payments are allowable (page 10).

- Accounting practices and internal controls of the villages, ORDEV/LDF, and the U.S. contractor were not adequate. We are recommending the reinstatement of training in financial management (page 15); an assessment of the value, location and condition of equipment procured with DD-I funds be made so that an equipment locator system can be established (page 17); and that local currency financial records be maintained at the U.S. contractor's official place of business (page 17).

- ORDEV/LDF does not always consider existing and established criteria for making loans. As a result, some of the projects are in trouble and have no reasonable expectation of earning a profit. We recommend that USAID/E and ORDEV/LDF review tile production projects located in the Menia Governorate to determine their financial viability and to reject future LDF loan applications for cattle fattening projects until the climate changes (page 19).

- The U.S. contractor claims overhead on the basis of independent consulting fees in violation of contract terms. A recovery of $49,417 needs to be made (page 21).

- Lastly, we recommend a recovery of LE4,050 ($5,786) representing procurement of a tractor from a country ineligible under AID Geographic Code 935 (page 23).

Summary of Management Comments

Responding to our draft report, USAID Management "Agrees that the project is not without problems. However, it is important to note that these are problems of administration and implementation. For the first time, villages are borrowing money to invest in revenue generating projects. The concept of borrowing funds, repaying interest and principal versus the traditional type of financing; i.e., grants, is a unique experience to most villages.

The DD-I activities have undoubtedly increased village councils' awareness of the economic value of both money and time, and spurred a genuine concern over the need for better bookkeeping and reporting methods. The project has also increased the quantity of goods produced as well as revenues in many of the villages involved."

A copy of our draft report was provided to USAID Management for their review. Their comments are included in this final report. In our view, the 21 recommendations in this report should be implemented to assist USAID Management in "...progressively achieving its aim of increasing the autonomous revenues of village councils throughout Egypt in order to help develop financial viability and development capability of local administration."

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Performance Of The U.S. Contractor Is Not Adequate

The contractor has not furnished required technical assistance for the design and application of accounting procedures to ORDEV, nor has the contractor made sufficient site visits to villages to provide financial advice, monitor project progress, and report to USAID/E. The lack of this advice, assistance and reporting, is the chief cause for problems inherent at the LDF village projects as shown throughout this report. The overall result is that village accounting and financial practices, internal controls, and reporting are not adequate. In addition, contractor resources have been diverted. The training advisor and other short-term consultants worked on non-project activities. As a result, the contractor's services were not commensurate with DD-I monies paid.

On April 23, 1979, AID signed a cost-plus-fixed-fee contract, AID/NE-C-1615, for $1,472,822 with Checchi and Company to provide technical assistance needed for the DD-I project. Major advisory services were detailed between three long-term key personnel. They were the team leader, financial advisor and program advisor. One quarter of the time for each individual was to have been in the field.

None of the key personnel spent 25 percent of their time in the field. The most glaring example is the contractor's financial advisor. To illustrate:

- There was no evidence of financial advisory services provided at any of the 10 villages we visited. Local administrators, lacking needed advice, followed instruction from cognizant governorate and markaz sources resulting in accounting practices that were not compatible to AID requirements.

- Available contractor field trip reports indicated that only two site visits over a period of 30 months were made to village projects by the contractor's long-term financial advisor. The majority of the financial advisor's time was spent in Cairo preparing and submitting local currency reimbursement reports to USAID/E and maintaining the local currency budget.

- The contractor was required to assist ORDEV to evaluate the impact of LDF-generated revenue on the village Local Services and Development Fund. But at seven of the 10 villages we visited, there was no impact because LDF-generated revenue had not been transferred by HEOs to the fund, and the contractor had not identified the condition.

- The contractor was required to accumulate and report to USAID/E all inputs into the DD-I project. But, actual disbursements were not known because the documents furnished by the contractor were estimates.

- Although the contractor and the LDF are located in the same offices, the contractor did not review ORDEV/LDF bank statements and accounts to determine the disposition or balance of funds.

- The cost, condition and location of equipment and commodities were not known by the contractor.

Consequently, the financial assistance required by the contract was not provided. These conditions were not reported to USAID/E.

A key to the USAID/E oversight role was to rely on the contractor for feedback on project progress, financial status, and problems in order to make valid decisions and adequate inputs for the project. The contract required:

- a detailed quarterly work plan that primarily identified technicians and specialists projected to be in Egypt during the period, and their objectives; and

- a quarterly summary of accomplishments, issues and program for implementation keyed to match the detailed quarterly work plan.

Reports, as submitted to the USAID, showed numbers of seminars/training sessions planned, numbers of participants scheduled to leave the country for training, numbers of new village loan applications and plans to visit new applicants. Accomplishments were presented on an event basis, but there was no comparison of accomplishments to that planned. The reports did not identify problem areas of on-going village projects, and did not provide information on project financial status. In sum, the reports provided little information of use to USAID in order to make management decisions about inputs into the project.

The services of the contractor's training advisor were used by ORDEV for non-project-related activity. For example, the training advisor participated in training programs organized by ORDEV for the Basic Village Services (BVS) project --an AID-financed project with its own training component. However, DD-I funds were used to pay all salary and local support costs for the training advisor. Also, two independent consultants serving as aquaculture specialists for the contractor stated that about 10 percent of their time was spent as consultants to the GOE Ministry of Agriculture. DD-I funds were used to pay salary and local support costs for their efforts as well.

The above conditions surfaced because the contractor did not obtain prior written permission from AID as required by the contract. The conditions were undetected because employees did not record the activities on contractor timesheets. As a result, the project did not receive full value for monies paid.

The contractor agreed that its monitoring and follow-up activities need to be improved. The contractor's view was that site visits were limited due to the lack of adequate transportation--vehicles furnished by AID to ORDEV were not available to them or were in disrepair.

In response to our draft report, USAID management acknowledged that the level of technical assistance offered by the contractor to LDF, particularly in the field of financial management, was less than optional. They stated that as a result of a mid-project review concluded in October 1981, USAID requested AID/W to negotiate a new technical assistance contract with Checci and Company. This new contract would phase out the services of the Finance and Management Advisor and the Production and Marketing Analyst. These two positions would be replaced by a small scale industry specialist position. USAID further believes that the services provided by Checchi and Company in support of the DD-I projects are essential to the progress of the LDF and are technically sound. In their view, USAID management believes that the measures described above will remedy the cited weakness in the contractor's performance, and are sufficient to ensure a sustained level of appropriate technical assistance.

Also in response to our draft report, USAID officials stated that in order to ensure maximum level of coordination, and to avoid possible overlap of training, activities offered under various projects, USAID instructed and encouraged the DD-I training advisor to work closely with another AID-financed project counterpart. Further, USAID sees no diversion from Checchi's contract scope of work in these actions. Nonetheless, we are concerned that the DD-I project did not receive the level of effort contracted and paid for.

Conclusions and Recommendations

The result of nonperformance by the contractor was twofold. First, ORDEV/LDF and villages were not given needed advice, and second, the cost to ORDEV/LDF and to USAID/E was high. The combined salary of the three long-term advisors alone exceeded $320,000 during the period audited.

The AID Administrator has frequently expressed concern with the effective management of contracts. As a result of these concerns, AID instructed that termination of contracts may be appropriate and should be used when a contractor does not improve after matters have been brought to its attention. Because the project grant agreement is to be extended, USAID anticipates that contract extension also will be necessary.

We recognize USAID's initial actions mentioned in their response to our draft report as a beginning to overcome the problems noted in their report. However, we make the following recommendations to assist USAID management implement project activities. In our view, USAID should assess contractor performance before extending the contract. Moreover, useful progress reports need to be provided to assist USAID Management decisions, and clarification is needed concerning use of contractor staff for other activities.

Recommendation No. 1

USAID/E assess the management and performance of Checchi and Company under Contract No. AID-NE-C-1615, and implement appropriate remedies.

Recommendation No. 2

USAID/E require Checchi and Company to compare accomplishments against plans in quarterly reporting to USAID/E.

Recommendation No. 3

USAID/E require Checchi and Company to obtain permission, in writing, for use of their personnel for other projects outside their contract scope of work and document on timesheets all services performed in Egypt, whether or not project-related, so that proper charges can be made to appropriate contracts.

ORDEV/LDF Project Monitoring And Implementation Is Ineffective

ORDEV/LDF monitoring of project activities needs to be improved. In order to monitor and implement the 226 LDF-financed village projects, ORDEV/LDF relied on: six independent local consultants from Egyptian universities who are experts in village project activities; a cadre of over 260 ORDEV-affiliated personnel working in governorates; seven permanent ORDEV/LDF headquarters employees who are technical specialists in project-related activities such as agricultural machinery, cattle, transportation, poultry and aquaculture; quarterly reporting from the villages; and the U.S. project consultant.

Independent consultants from Egyptian universities made visits to villages to identify problems, provide advice and offer corrective recommendations, but the frequency of their trips declined due to inadequate travel and per diem funds from ORDEV/LDF. The ORDEV-affiliated personnel working in Governorates did not effectively monitor the LDF village projects because they were not ORDEV but Governorate employees. Also, the headquarters technical specialists were reluctant to make site visits because ORDEV/LDF travel reimbursements did not cover the associated cost. Even though the U.S. contractor provided assistance to ORDEV in establishing the LDF, developing loan criteria and training, and increasing village awareness of the LDF, there were serious deficiencies of monitoring, providing financial advice and reporting to both ORDEV and to the USAID/E.

As a result, managers of LDF-financed projects in villages did not receive guidance as needed. Questionable accounting practices and weak internal controls were commonplace but were not identified and corrected. Also LDF funds were not always effectively used for agreed to village project purposes.

Project monitoring requires periodic site visits to validate information received in activity and progress reports, provide advice as required, identify problem areas, assure that goods and services financed are utilized effectively, and evaluate and report performance. Also, successful project implementation requires that each party effectively carry out its designated project responsibility. Problems stemming from inadequate performance contribute to inefficient and uneconomical use of project resources.

Performance of ORDEV-affiliated personnel

ORDEV-affiliated personnel working at the Governorates did not effectively monitor the LDF projects. ORDEV/LDF portrayed, and according to AID's project paper design, the 260-odd ORDEV-affiliated personnel were to be an integral part of ORDEV operating management. However, individuals do not work for ORDEV but are employed by the Governorates. At the eight Governorates visited, the primary responsibility of the local ORDEV representatives was merely to act as liaison for interested parties that visited the LDF village projects. These representatives were connected to ORDEV only in the sense of having received ORDEV-sponsored training. They were actually recruited and appointed and their salaries were paid by the governorates. Duties were assigned to them according to governorate, not ORDEV priorities. The 260-odd personnel were ORDEV representatives only in name, and the ORDEV monitoring function was not their primary duty. As a result, problems experienced by LDF-financed projects were not identified, and periodic reporting to effectively manage the village projects was not formalized. For example:

- HEOs at two villages with LDF-financed projects in the Menia Governorate said that visits by the local ORDEV representative were scarce. At the time of our visit one of the projects had almost collapsed. The accounting and internal control functions were in disarray. Local ORDEV representative had not visited the village since AID's mid-project evaluation, and was not aware that the village accountant needed training.

- A village in the Fayoum Governorate bypassed the local ORDEV representative and filed program and financial reports directly with ORDEV/LDF headquarters. While appearing to be knowledgeable of the projects, the ORDEV representative was not required to report.

- The local ORDEV representative in the Gharbia Governorate delegated monitoring and reporting duties to a unit of the markaz. Reports from the markaz stopped at the governorate--there was no requirement to report to ORDEV/LDF.

- At the Beheira Governorate the local ORDEV representative visited the LDF village projects but there was no evidence of reporting to ORDEV/LDF headquarters.

- The local ORDEV representative at the Sharkia Governorate said that he could not monitor the projects because he had no control over use of the AID-financed vehicle. On the day of our visit he was not aware that the vehicle was being used to transport governorate officials to Cairo.

The 20 AID-financed vehicles costing $205,272 were provided so that the local ORDEV representatives could visit the LDF-financed village projects. However, ORDEV representatives told us that they did not have access to the vehicles. We found only one of eight vehicles in operating condition. The others needed repairs, but spare parts were not available and had not been requested. Also, of the eight vehicles we observed a vehicle use log was maintained for only one vehicle. The log showed that the vehicle was used for nonproject purposes. An ORDEV representative in another governorate stated that the vehicle assigned there was used to transport local sports teams and for social events.

USAID management agreed with our findings that duties were assigned to ORDEV representatives according to governorate, not ORDEV, priority. They stated that it is very doubtful that ORDEV can influence the governorates to change the role of local ORDEV representatives. Further, that USAID could not, and in fact, should not instruct the GOE or local government units to change its internal organizational and bureaucratic structure to accommodate the reporting and follow-up requirements of the LDF projects.

We cannot agree with USAID's decision, because increased liaison and cooperation of the Governorates is needed to implement the monitoring and reporting functions required for LDF village projects. Moreover, AID's project planners recognized the importance of the monitoring function of ORDEV field staff. Furthermore, ORDEV staff was to continue and report to ORDEV/LDF on performance until the project was completed. These monitoring reports would be a "...comprehensive functional system which will allow ORDEV to monitor its program, shift emphasis and alter implementation and policy procedures as necessary and in response to village conditions."

Site visits of ORDEV/LDF technical specialists

Permanent ORDEV/LDF technical specialists had never visited six of the 10 villages included in our audit. The U.S. contractor said that ORDEV reimbursements to the specialists did not cover expenses incurred from field trips; as a result, the specialists were reluctant to make site visits.

The specialists have received recent training in their technical specialties, and can contribute to the development of social and vocational skills in the villages. Funds should be provided to allow them to carry out their monitoring responsibility.

Village progress reporting

ORDEV/LDF and the U.S. contractor developed a format to be used by villages for quarterly reports. The format required target dates for project start-up, status of project implementation during the quarter, identification of problems encountered and how solved, problems remaining, and financial and production data.

Few of the villages submitted the required reports. Information was furnished in the form of letters, cables, or in report formats designed by the villages, markaz or governorate. ORDEV/LDF headquarters personnel then transcribed these reports in the LDF format. ORDEV/LDF put more emphasis on transcribing the data received than analyzing report data. For example, even though a cattle fattening project awarded bonus and incentive payments during the period June 1980 through August 1980 the project generated no revenue during this time. An analysis of report information during this period would have alerted project management that incentive payments were not financially justified.

Conclusions and Recommendations

The role of the local ORDEV representatives needs to be strengthened to implement their monitoring and reporting functions. Moreover, the condition of most of the AID-financed vehicles observed during the audit indicates that action is needed to obtain the condition of AID-financed vehicles. Also, the technical specialists need to do a better job of monitoring.

Recommendation No. 4

USAID/E through ORDEV/LDF coordinate with Governorates of the GOE to formalize the role of the local ORDEV representative according to mutual priorities established, and initiate a system of reporting from Governorates to ORDEV/LDF.

Recommendation No. 5

USAID/E request ORDEV to pay reasonable field expenses of the LDF technical specialists, and require documentation of site visits by LDF technical specialists.

Recommendation No. 6

USAID/E in coordination with ORDEV/LDF obtain status reports on the condition of the [illegible] AID-financed vehicles costing $205,272 of DL [illegible] project funds and take appropriate corrective or disposal actions.

Interest Income Needs To Be Refunded

ORDEV/LDF earned interest of LE152,242 through December 31, 1981 by making 13 time deposits with AID grant funds. These funds were to be used for loans to village councils for income producing projects. The interest had not been returned to AID because USAID/E informed ORDEV/LDF that it could retain the interest. In our view, U.S. Treasury fiscal requirements and the project grant agreement require that the interest be refunded to AID in dollars. Thus, the transfer of AID funds to time deposits before making disbursement for authorized project purposes (loans to villages) resulted in increased interest costs to the U.S. Government.

ORDEV/LDF received the initial LE1,225,000 ($1,750,000) check from AID during October 1979. Before using the funds to make loans to villages, ORDEV/LDF made three time deposits for LE200,000, LE325,000 and LE700,000 at the Chase National Bank (Egypt) S.A.E. Two time deposits matured in February 1980 and the third matured in April 1980. Interest earned on the three time deposits totalled LE38,181.

In April 1980, ORDEV/LDF made another LE369,000 time deposit which matured in December 1980. Interest earned was LE12,154.

During April 1980, ORDEV/LDF received a second check from AID for LE1,000,000 ($1,428,571). This amount was used for two time deposits at Chase National for LE300,000 and LE700,000. Through February 1981 these deposits earned interest of LE31,036.

A third AID check for LE1,000,000 ($1,428,571) was received during December 1980. ORDEV/LDF used this amount for two time deposits of LE200,000 and LE800,000. Through April 1981 these deposits had accrued interest of LE21,590.

In April 1981 ORDEV/LDF made a new time deposit of LE287,500. This time deposit remained in force through July 1981 and earned interest of LE7,237. ORDEV/LDF used LE38,000 of interest earned to make another time deposit which accrued additional interest of LE4,295.

In March 1981 ORDEV/LDF received a fourth AID check. This check for LE1,000,000 ($1,428,571) was invested in three time deposits of LE100,000, LE200,000 and LE700,000. At December 31, 1981 these three time deposits had accrued interest of LE37,749.

In August 1981 AID gave a fifth check to ORDEV/LDF in an amount of LE115,000 ($164,285). ORDEV/LDF deposited this amount into their current account at Chase National, and later transferred these funds to another bank for loans to village councils in accordance with the grant agreement.

The above described time deposits varied in term from 15 days to three months. Interest rates fluctuated from 4.5 percent to 8.5 percent per annum. ORDEV/LDF renewed the time deposits repeatedly. For example, one time deposit accrued interest of five percent per annum on a term of 15 days and was renewed several times.

While frequent renewals of time deposits were taking place, loans were not made to village councils. The initial AID check was received in October 1979, but the first group of loans was not made until five months had passed. When the second AID check was received in April 1980 four months elapsed before the funds were used to make loans to village councils. Some village loan applications had been received by ORDEV/LDF as long as 10 months before checks were written. In response to our draft report, USAID officials stated that slowness in the approval of loan applications caused delays in making loans. Nevertheless, USAID officials released funds in advance of actual need which created a surplus of funds at ORDEV.

In January 1980, the USAID/E project officer obtained an opinion from the USAID/E legal officer concerning retention of interest earned by the capitalized LDF. The legal officer concluded that the LDF may retain the interest earned by these funds because (i) the nature of the fund established under the Development Decentralization-One Project has as one of its major elements the very establishment of a loan fund from which sub-loans will be made, (ii) capitalization of the fund itself, rather than potential subactivities was the authorized disbursement under the project, (iii) the furnishing of LDF capitalization by AID was a resource transfer analogous to that of an unconditional grant, and (iv) it would be difficult, if not impossible, to segregate interest earned by the capitalized fund itself from interest earned by the LDF from loan repayments. USAID/E informed ORDEV/LDF of this conclusion and provided a copy of the January 14, 1980 memorandum.

We agree with the grant agreement that interest earned from LDF loans made to village councils remain with the fund to help with operating expenses; however, in our view, interest was earned on idle funds prior to their authorized use,capitalization of the Local Development Fund. Time deposits were established by ORDEV and interest was earned prior to their authorized use--loans to village councils for income producing projects.

The grant agreement and U.S. government regulations are clear on this matter. According to the project paper and grant agreement LDF project disbursements are to be made for loans to selected village councils. The project grant agreement is consistent with AID and U.S. government criteria concerning interest refunds. The project grant agreement requires that:

> "Any interest or other earnings on grant funds disbursed by A.I.D. to the grantee under this Agreement prior to the authorized use of such funds for the Project will be returned to A.I.D. in U.S. dollars by the grantee."

The U.S. Treasury Fiscal Requirements Manual, Chapter 8000, states that:

> "Except where specifically prohibited by law, agencies will require that all interest earned by recipients on advances of Federal funds be remitted to the agency. The agency will promptly deposit such interest in the General Account of the U.S. Treasury..."

A Comptroller General Decision (I Comp. Gen. 652 (1922) regarding grants of U.S.-owned funds states:

> "If such funds earn interest prior to the time they are spent by the grantee for the specified purposes, any interest may not be used by the grantee or the granting agency but must be returned to the Treasury."

From the interest earned on capitalized AID funds during the period August 1979 through December 31, 1981, ORDEV/LDF disbursed LE37,244 for incentives and bonuses paid to ORDEV/LDF headquarters' employees in Cairo. The payments were additional to their regular salary paid by the GOE and were not authorized by AID.

Also, during November 1981, ORDEV/LDF advanced LE2,000 from interest earned on funds intended to capitalize the LDF to a U.S. contractor not affiliated with the DD-I project. This contractor was working with AID's Basic Village Services (BVS) project also managed by ORDEV. It was agreed that the advance would be repaid by December 1981. However, at the end of our audit field work the advance was outstanding. Subsequent to our audit exit conference, USAID officials collected the LE2,000 funds advanced; therefore, we are not making a recommendation at this time.

Conclusions and Recommendations

The transfer of AID grant funds to time deposits created a disincentive for ORDEV/LDF to make timely loans to village councils. Moreover, the interest earned are not controlled by the project budget, and are being used for bonuses and for other non-authorized payments. In our view, U.S. Treasury requirements and the grant agreement require that interest earned prior to the authorized use of grant funds be returned to AID. Therefore, we recommend the following actions.

Recommendation No. 7

USAID/E collect from ORDEV/LDF $217,489 (LE152,242) of interest earned on time deposits through December 31, 1981, on AID funds intended to capitalize the LDF.

Recommendation No. 8

USAID/E determine and collect from ORDEV/LDF interest earned on time deposits subsequent to our audit.

Bonus And Incentive Payments Need To Be Clarified

Bonus and incentive payments are paid to GOE employees assigned to work in villages from revenues earned by LDF-financed village projects. ORDEV/LDF strongly encourages bonus and incentive payments on a basis that GOE employees are not highly motivated. They contend that an incentive pay component is necessary if village projects are to have any reasonable hope for success. In our view, Egyptian public law and corresponding executive regulation prohibit bonus and incentive payments to popularly elected village council members and GOE officials. ORDEV/LDF has not developed and disseminated clear guidelines to the villages concerning these payments, but has relied on the issuance of local Governorate Decrees. These decrees contradict Egyptian public law. As a result, LDF-financed project revenues have been used for bonus and incentive payments which have a negative impact on project viability. The following examples illustrate the misuse of revenues earned from village projects.

At a LDF-financed village transportation project in the Beni Suef Governorate, incentives were calculated at 25 percent of net profit and again at 10 percent of total revenue. The smaller calculated amount became the incentive distribution. Over LE1,500 of incentives and bonuses were distributed to workers, the HEO and executive council, and to markaz and governorate staff.

A similar LDF-financed project in the Giza Governorate did not have a verifiable formula for calculating incentives. Nonetheless, incentives were determined and distributed to workers, the HEO, and the executive council prior to the determination of net income. Incentives averaged over 45 percent of gross profit.

An official with oversight responsibility for both the AID-financed BVS and the DD-I projects in the Fayoum Governorate advised that payment of incentives was a secret. In a follow-up review officials were reluctant to furnish profit and profit distribution information.

At a LDF-financed village cattle-fattening project located in the Beheira Governorate, bonuses were given prior to the determination of net income. At the time net income(minus the bonus payment) was less than LE2,000. During the subsequent period, expenditures exceeded revenue by over LE23,000.

ORDEV/LDF considers bonus and incentive payments as allowable and applicable to LDF-financed village projects based on decrees and regulations issued by each of the governorates. For example, a local regulation under Decree No. 421/1981 issued by the Fayoum Governorate contains methodologies for incentive distribution based on levels of performance for different types of projects.

In the cattle fattening projects when levels of performance are achieved, a bonus of LE2 per head, or 2 percent of net profit whichever is more, is paid to employees of the project, provided that 15 percent is kept for the HEO and 10 percent for the veterinarian.

Under the poultry projects when levels of performance are achieved, 25 percent of net profit is distributed as follows: 15 percent HEO; 10 percent veterinarian; and 75 percent to rest of employees.

The DD-I project is governed by the requirements of national law and executive regulation which we believed prohibit payment of incentive and bonuses. Article 90 of Egyptian Public Law 43/1979 states that:

> "Local Popular Council's member shall not be paid any salary or bonus for his work. It is however permissible to pay members of Local Popular Councils, and member(s) of executive councils money to cover actual expense* paid by the members according to the executive regulations."

Article 35 of the Executive Regulation which implements the law is stated here in full:

> "Payments to be made to members of the local public council and the executive council of the Governorate, in return for the burdens they bear* to attend the sessions of the council and its committees, and the sessions of the executive council, on the basis of LE4 per session and a maximum of LE15 per month for each member.
>
> "And for the members of the local public councils at the Markaz, Cities and Districts, and members of executive councils there, the allowance for attending sessions is LE2 per session and a maximum of LE8 per month for each member.
>
> "And for the members of the local public councils at the villages, and members of executive councils there, the allowance for attending sessions is LE1 and a maximum of LE4 per month.
>
> "And in all cases the session is considered one until completing the agenda prepared for it.
>
> "And for the Head of the Local Public Council at the Governorate an allowance of LE40 for representation, and for the head of the Markaz, City and District LE20, and for the Head of the Village LE10.
>
> "Also, for the head of the local unit at the village an allowance of LE15 per month for the nature of the work.
>
> "The deduction decreed by Law No. 30 for 1967 is effective on the allowances in this regulation."

Conclusions and Recommendations

USAID needs to determine if Egyptian public law and executive regulation applicable to the DD-I project prohibits bonus and incentive payments. In our view, under the national public law payments made to popularly elected village council members and to executive council members are not intended to be in the form of bonus and incentive payments, but are limited to reasonable allowances for official services performed. Moreover, the allowances cited by Executive Regulation are to be shared by all of the village projects from which revenues are deposited into the Local Services and Development Fund. Thus, the LDF-financed village projects appear to have borne a disproportionate share of the financial burden. Accordingly, we recommend the following.

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* The Arabic phrase is yatakabadonaho min aaba which literally translated means burdens they bear.

Recommendation No. 9

> USAID/E through ORDEV/LDF obtain legal interpretation from the Ministry of Local Government whether or not bonus and incentive payments made to GOE employees are legal and appropriate under Egyptian Public Law and Executive Regulation.

Profits Should Be Transferred To The Local Services And Development Fund

Profits generated by LDF-financed village projects are not being transferred to village Local Services and Development Funds as intended. HEOs and GOE-appointed executive councils are maintaining separate village or markaz banking accounts for LDF projects. Lacking access to these segregated bank accounts popularly elected village councils are not determining use of revenues generated. Instead, HEOs and GOE officials use project revenues for bonus and incentive payments. This practice does not agree with the DD-I project purpose, and could have a negative impact on implementation of village council projects.

A LDF-financed village transportation project located in the Giza Governorate recorded net profit of LE2,758 from May 14, 1981 through December 31, 1981. This income was not transferred to the village council's Local Services and Development Fund, but remained in a separate bank account opened by the HEO and executive council located in the markaz. Since control of project funds rest with the HEO and executive council, they were able to award themselves LE1,437 of incentives and bonuses prior to the determination of net income.

Another village transportation project located in the Beni Suef Governorate financed by a LDF loan recorded LE2,896 of net income for the period December 16, 1980 through June 30, 1981. The proceeds were maintained in an account controlled by the HEO and by the markaz. Before the determination of net income, incentives of LE872 were determined and distributed to workers on the project. After net income had been determined, bonuses of LE724 were distributed to the HEO and executive council and to markaz and governorate staff. The combination of incentives and bonuses equaled 37.1 percent of total project profit by the end of the period.

A LDF-financed poultry project located in the Beheira Governorate was operating at a LE19,000 loss at the time of our visit. Loan funds were maintained in a separate bank account and controlled by the HEO. Although the project was losing money, LE215 of salary, bonuses and incentives were distributed. Due to commingling of salary with bonus and incentive payments on the accounts, we could not determine valid labor costs against questionable bonus and incentive payments.

In the villages visited, GOE-appointed officials were more involved in obtaining LDF loans than the elected village councils. In some cases, the HEO designed the project, processed the loan application and negotiated with ORDEV/LDF. Consequently, the HEO and GOE-appointed staff considered that the village project belonged to them. However, the elected village council is the responsible entity as required by the DD-I project. AID's project paper states that individual subprojects benefit the entire villages through generation of additional money for the 'Special Accounts' This money is then used for further income producing activities or for community development, infrastructure and social services. The project paper also states that the village council if elected is answerable to the electorate for the use of LDF project account funds and to profits accruing to the "Special Account".

Egyptian Public Law states that village financial resources include loans contracted by the council, and that resources of the account for services and local development shall be used in the village according to the decisions of the village's Local Popular Council.

Conclusions and Recommendations

Withholding funds from the Local Services and Development Fund defeats the project purpose by depriving villages from determining the use of profits generated by LDF-financed projects. The popularly elected village councils, not the GOE-appointed executive councils, are responsible for these determinations.

While separate project bank accounts for the LDF-financed village projects may ease the burden of accountability, procedures and controls need to be established to ensure that popularly elected village councils determine the use of project profits. Nonetheless, if HEOs and executive councils elect to maintain separate project bank accounts, profits should be transferred to the public Local Services and Development Fund on a periodic basis. Therefore, we recommend the following actions be initiated.

Recommendation No. 10

USAID/E in coordination with ORDEV/LDF establish procedures and controls to ensure that village project profits are transferred to village Local Services and Development Fund, and that transfers are clearly identified on financial reporting from villages to ORDEV/LDF.

Recommendation No. 11

USAID/E through ORDEV/LDF require that village quarterly financial reports show the disposition of project funds, in order to improve controls by the elected village councils over the use of LDF project funds.

Accounting Practices And Internal Controls Need Improvement

Accounting practices and internal controls for the LDF-financed village projects are poor, and financial records contain numerous errors and unexplained entries. Also, actual project revenues and expenditures are not properly recorded, advances to individuals are recorded as expenditures, and actual cost of purchases or services are not always documented. Moreover, ORDEV/LDF accountability for village loan repayments is not accurate, and systematic reconciliation are needed. In addition, ORDEV/LDF cannot account for all equipment and equipment costs. Lastly, financial records for U.S. contractor local currency costs are not adequate. Thus, training in financial management at the villages needs to be reinstated, to ensure that project objectives are reached. Moreover, unless improvements are made there is little chance for village projects to have any sustaining viability.

Village records are poor

Training in financial management for village accountants needs to be reinstated. At the villages, accountants had been replaced by others who did not receive training, qualified accountants were not assigned at the village level, and accountants were in need of refresher courses. The following illustrate the need to improve village financial management.

At a LE15,000 LDF-financed brick plant revenue and expenditure data could not be verified because supporting receipts, invoices and other documents were not available. The village accountant had not received training in basic bookkeeping. There were no journals or ledgers to account for over LE20,000 advanced to the HEO or to executive council members. The advances were recorded as expenditures, and there were no documents to support project costs. The local ORDEV representative requested that the village accountant visit the governorate for training after accounting discrepancies were identified and surfaced by the audit team.

A village accountant was not assigned to another village LDF project we visited. Official accounting records for a LE9,000 transportation project were maintained at the markaz. However, one GOE-appointed executive council member at the village kept subsidiary financial records, and he received incentives from project funds as well as a regular GOE salary. In addition, internal controls for the project were weak, that is, one individual issued and collected both the controlling receipts and monies generated in addition to bank deposit duties and custodianship of the bank book.

In another village we visited a poultry project. Financial records were not adequate to identify the costs of their project financed by a LE40,000 LDF loan. Project accounting was commingled with that of the other village enterprises, and entries were unexplained and misposted. The village accountant was new and had not received training.

At a village cattle fattening project initiated with a LDF loan of LE24,000, advances were made to employees, and purchases were not supported by evidence of actual cost. According to available records, cattle was being purchased for over LE400 and sold for less than LE350 each. Misclassifications of costs contributed to this discrepancy.

Governorate, markaz, and villages are required to follow standards of accounting as set forth by the GOE. Adequate financial records required under the grant agreement differ but can be incorporated into the accounting procedures of the GOE. During 1979 USAID/Es project officer assisted ORDEV/LDF incorporate AID grant agreement requirements into the existing GOE project accounting system. The ORDEV/LDF accountant believed that AID grant requirements were both easily applied and practical, and with the USAID/E project officer arranged training sessions for accountants serving on village executive councils. Participants attending these sessions indicated that the training was beneficial and had been applied to project accounting. However, during 1980, the training sessions stopped, and LDF projects were not monitored to assure that adequate financial records were maintained. We noted during our visits to project sites that accounting and internal controls for LDF-financed village projects had deteriorated.

Reconciliation of loan repayments not made

Discrepancies existed between ORDEV/LDF cash receipts from village repayments to the amounts deposited in banks. ORDEV/LDF received virtually no assistance from the U.S. contractor to implement a system of periodic reconciliation. As a result information needed by managers to assess the ability of villages to repay loans was not fully accurate. As the volume of village repayments continues to increase the potential for proportionate discrepancies also increases.

As of December 31, 1981 the status of village loan repayments to ORDEV/LDF was:

Amounts due LDF from villages		LE284,672
Amounts received at 12/31/81	LE234,495	
Amounts deposited at 12/31/81	228,808	
Checks in-transit *	6,843	
Subtotal	235,651	
Unexplained difference **	LE (1,156)	

* Checks forwarded by villages prior to December 31, 1981 and not yet credited in banks at February 28, 1982.

** The ORDEV/LDF accountant was not able to provide satisfactory explanation for the difference.

Equipment locator system is needed

ORDEV/LDF could not provide records to show the condition, location and cost of all equipment purchased with AID grant funds. An equipment locator system is needed to assure effective use of project equipment.

As of February 1982 USAID/E had purchased vehicles and other equipment costing $312,962, and had advanced LE61,910 to ORDEV/LDF for local currency equipment purchases. Of this total, ORDEV/LDF could not locate or account for equipment costing $60,495 and LE61,910.

ORDEV also used equipment procured with DD-I project funds for other than project purposes. For example, ORDEV removed a DD-I financed xerox machine from the LDF office without prior announcement. The machine was used for an ORDEV-sponsored conference of Middle East and African countries. LDF reproduction operations were at a standstill during the period.

Section B.5.(b) of the Standard Provisions Annex of the project grant agreement required ORDEV to maintain records adequate to show the receipt and use of goods and services acquired under the grant.

ORDEV needs to establish necessary records as required by the grant agreement to determine effective use of and maintain controls over project resources.

Local currency financial records are lacking

The long-term financial advisor maintained the accounting records for local currency costs of the contractor even though it was not included in the contract scope of work. Accounting records maintained were not adequate because they were incomplete, not reconciled, and not traceable to supporting details. Furthermore, local currency financial records were maintained at the financial advisor's residence, not at the contractor's office. As a result, there was a lack of control and accountability for local currency expenditures of LE231,163.

Local currency funds received from USAID/E were deposited into a local checking account. Periodic checks, signed by the team leader and the financial advisor, normally of about LE5,000 to LE10,000, were written and expenditures were paid in cash. The financial advisor logged cash receipts and expenditures in a small notebook, and each category of expenditure was identified by a numerical code.

The notebook did not provide clear verification of actual fund balances or actual expenses incurred, and periodic reconciliation of entries in the notebook to the contractor's checking account were not made. Entries were posted from the notebook to detailed summaries of expenditures attached to monthly billing vouchers sent to the USAID/E. The line items posted on the attachments were a combination of two or more of the numerical codes, and original supporting receipts were not always attached to billing vouchers submitted to USAID/E for payment.

In order, to review and approve the contractor's local currency billings, the USAID/E Controller expended an excessive amount of time because the contractor's claims were not fully supported. In our view, maintenance of accounting records could be implemented by a qualified local bookkeeper at about one-tenth of the labor costs being paid to the current financial advisor. His services were required for other functions under the contract.

Our review of available records also showed that several payments for lease rentals and local office salaries were supported by scraps of paper signed by the payee. Reported monthly disbursements for lease agreements are as follows:

Lease Agreement for	Amount
Chief of Party	LE1,500
Program Advisor	1,500
Financial Advisor	800
Training Advisor	750
Office Space	750

The contractor did not furnish signed lease agreements for the above transactions. Therefore, we question whether or not the monthly sums claimed were, in fact, valid expenditures.

Conclusions and Recommendations

Training in financial management at the village level needs to be reinstated. The U.S. contractor had not provided financial management, advice and assistance as required by the contract. Moreover, an equipment locator system is needed to assure that project financed equipment is used for the project. Project records did not identify AID-financed equipment, therefore, we could not account for equipment costing $60,495 and LE61,910. Also, local currency financial records maintained by the U.S. contractor were incomplete, not reconciled and were not supported with adequate documents for local currency expenditures. Therefore, USAID/E and ORDEV/LDF will have to bear the burden of coordinating and implementing actions to overcome accounting and internal control problems. Accordingly, we recommend the following actions be taken.

Recommendation No. 12

USAID/E in coordination with ORDEV/LDF make arrangements to reinstate training in financial management for village accountants.

Recommendation No. 13

USAID/E instruct ORDEV/LDF to reconcile, on a periodic basis, cash receipts from village loan repayments to bank deposit statements, and institute a system of reporting to USAID/E.

Recommendation No. 14

USAID/E require ORDEV to determine the value, location, and condition of all equipment procured with project funds, establish an equipment locator system, and furnish a copy of the documentation to USAID/E. USAID/E should recover the cost of equipment that cannot be located.

Recommendation No. 15

USAID/E require Checchi and Company to maintain at their official place of business adequate to financial records to support local currency costs of Grant No. 263-G-80-006; and to obtain the services of a qualified local bookkeeper to keep these financial records.

Recommendation No. 16

USAID/E require the U.S. contractor to furnish signed lease agreements for residential housing and office space.

LDF Management Planning Is Lacking

Criteria to be considered in the evaluation and approval of loan applications was not always used. More emphasis was placed on the volume of loans that could be generated, and some loans were approved based on political considerations. As a result, some LDF-financed village projects are in trouble, and have no reasonable expectation of earning a profit. The HEOs and executive councils, as well as markaz and governorates, assumed no liability, yet in some cases, they were instrumental in persuading ORDEV/LDF to make the loan awards. Thus, popularly elected village councils inherited the liability and are held responsible for the loan repayments.

Several key factors were to be considered in the evaluation of LDF loan applications. They included:

- projects must show a reasonable expectation of earning a profit in a relatively short period of time;

- village councils must have a history of credit worthiness;

- projects that receive additional financial support from the village and have assets that may be attached for collateral would receive preference; and

- geographic locations are to be considered in evaluation of projects applications.

The following examples illustrate the need for better project evaluation:

At a LDF-financed tile plant located in the Menia Governorate, total tile production from inception, June 7, 1981, through December 31, 1981 was only 753.5 square meters. We were told that daily average production was 3.7 square meters which was not enough to cover the direct and overhead production expense. The local ORDEV representative considered the project a failure as a daily minimum production of 40 square meters was required for sale in order to meet expense. There was a low demand for tiles, and they were being produced as orders were received. The village HEO initiated the loan application, and the HEO said that the project was an alternative choice, but ORDEV/LDF approved the loan based on tile production.

ORDEV/LDF awarded identical loans for LE15,000 each in the Menia Governorate for tile production. Loans were made to three villages that surround one markaz. These villages are close to each other and compete in the local tile market.

We visited a LDF-financed village cattle fattening project located in the Beheira Governorate. This project operated at a loss of LE20,589 from start-up on April 1, 1980 through June 30, 1981. Financial information was not available for the period July 1, 1981 through December 31, 1981--the audit cutoff. Based on the available project accounting records, cattle had been purchased at a price higher than their price at final sale. The HEO intentionally suspended sales for a period of about seven months, and only three head were sold from July 1, 1981 through December 31, 1981.

In a decree effective October 1, 1980 the GOE established fixed prices for live animals sold for slaughter, carcasses sold to butchers, and red meat sold at retail outlets. GOE's fixed price controls over sales of live animals and red meat affect the profitability of cattle fattening projects.

Live cattle sold to slaughter houses before the decree brought as much as LE1.40 to 1.50 a kilogram. The decree limited the highest price for a live animal to LE1.15 a kilogram--a reduction of about 25 percent. Retail beef prices at private stores for lowerpriced cuts increased over 33 percent in the six-month period prior to the ban on slaughter. Prices increased from LE2.00 to LE2.70 a kilogram, and higher-priced cuts increased from LE2.70 to LE3.50 per kilogram. The decree limited the maximum price to about LE2.50 a kilogram--again a reduction of around 25 percent.

Even though the price of red meat was fixed and LDF cattle fattening projects in force did not have a reasonable expectation of earning a profit, ORDEV/LDF continued to make loans for cattle fattening projects. Responsible USAID/E officials told us that ORDEV/LDF continued to award loans for cattle fattening projects because ORDEV/LDF had received political pressure from the governorates to furnish red meat. From the effective date of price restrictions (October 1, 1980) through December 31, 1981, ORDEV/LDF awarded 19 loans in an amount of LE381,000 (over $457,000) for village cattle fattening projects.

Conclusions and Recommendations

AID's project as designated and supported by Egyptian Public Law holds popularly elected village councils responsible for LDF loan repayments. The governorates, markaz, and HEOs and executive councils are released from any liability, and their function is to assist in planning, to implement projects, and to safeguard village resources. LDF monies were intended for income generating enterprises in villages as determined by the popularly elected village councils. In our view, there is doubt that these projects noted above will generate income. Therefore, we recommend the following actions be taken.

Recommendation No. 17

USAID/E and ORDEV/LDF review each of the LDF-financed tile production projects located in the villages of Sandafa El-Far, Agou Gerg, and Shalakam in the Menia Governorate, make a determination whether or not the popularly elected village councils can repay the loans, and take appropriate corrective actions.

Recommendation No. 18

USAID/E instruct ORDEV/LDF to reject future LDF loan applications for village cattle fattening projects until the climate improves.

Questioned Costs Under AID/W-Direct Contract

On April 23, 1979 AID signed a $1,472,872 cost-plus-fixed-fee contract (AID/NE-C-1615) with Checchi and Company to provide technical assistance for the DD-I project. At December 31, 1981 the contractor claimed cost totaling $1,167,811. AID reimbursed the contractor $1,164,189. We have questioned dollar reimbursements of $49,417. The questioned dollar costs consist of $46,267 claimed as overhead on consultant fees, and $3,150 of corresponding fixed fee adjustments. Exhibit B summarizes dollar costs of the contractor.

The contract provisions state that overhead is to be billed based on the percentages of authorized base salaries of contractor employees. The categories of contractor employees and overhead to be billed as a percentage of their base salaries are:

Employee Category	Percentage of Overhead
Long-Term Field Staff	89
Home Office	105
Short-Term Specialists	60

The contract further provides that overhead is not applicable and cannot be billed based on salaries or fees paid to "Outside Consultants" meaning non-employees. These fees are not a part of the "overhead base".

The contractor obtained outside consultants and assigned them to Egypt to perform the functions set forth under the short-term employee category. AID was billed overhead as if they were salaried employees. As a result, the contractor received $46,267 of funds for which it was not entitled.

The basis for payments between the contractor and its consultants was the number of days multiplied by the daily rate. For example, during February 1982, one of the consultants worked 22 days at $192 per day. The resultant fee paid by the contractor was $4,224, and there were no deductions for income taxes, insurance, or other employee benefits.

Contract No. AID/NE-C-1615 is an agreement between the U.S. contractor and the U.S. Government. The Federal Procurement Regulations (FPR) and the AID Procurement Regulations (AIDPR) apply and are included in the contract.

The FPR instructs that once an appropriate base for the distribution of indirect costs (overhead) has been accepted, such base shall not be changed. The contractor changed the agreed upon base by billing the Agency for overhead based on consulting fees incurred. None of the consultants were bona fide employees of the contractor at the time of the billings. They were not eligible for inclusion in the authorized labor base. Local support costs such as reproduction, rent, administrative salaries, telephone and telegraph were paid direct from local currencies made available by either USAID/E or by ORDEV for these consultants. Thus, the monies recouped by the contractor from overhead billings based on fees of the consultants were unauthorized.

Recommendation No. 19

USAID/E collect $46,267 representing overhead reimbursements made to Checchi and Company based on consultant fees, and $3,150 of corresponding fixed fee under Contract No. AID/NE-C-1615 for the period April 23, 1979 through December 31, 1981.

Recommendation No. 20

USAID/E determine and recover overhead payments made to Checchi and Company on the basis of consultant fees for the period January 1, 1982 through the present period under Contract No. AID/NE-C-1615.

Ineligible Procurement With DD-I Funds

In December 1980 ORDEV/LDF loaned LE15,000 to the village of El-Hagarssa located in the Sharkia Governorate for a tractor and transportation project. Using loan proceeds the village procured one pick-up truck, one tractor, and one trailor.

During December 1980 the HEO deposited LE4,900 of LDF funds to confirm the order for the delivery of a NASR-type tractor by July 1981. The tractor was not delivered as scheduled. Thus, on November 24, 1981 the HEO purchased a Zeitor, 67 horesepower tractor at a price of LE4,050 for the project. The Zeitor tractor is of Czechoslovakian origin.

The DD-I project places restrictions on commodities procured in projects utilizing loans from LDF. In order to satisfy conditions precedent to disbursement for establishment of the LDF, ORDEV was obligated to require that all commodities procured in projects undertaken by village councils utilizing loans from LDF will be from countries eligible under AID Code 935. Czechoslovakia is ineligible under AID Geographic Code 935. It is also excluded from waiver provisions for off-the-shelf procurement.

Recommendation No. 21

USAID/E recover LE4,050 ($5,786) representing ineligible procurement of a Zeitor tractor by the village of El-Hagarssa located in the Sharkia Governorate.

THE DEVELOPMENT DECENTRALIZATION-ONE PROJECT
PROJECT NO. 263-0021
SUMMARY OF LOCAL DEVELOPMENT FUND (LDF) LOANS
FROM INCEPTION THROUGH DECEMBER 31, 1981

GOVERNORATE	CATTLE FATTENING 1/		POULTRY 2/		TRANSPORTATION 3/		OTHER 4/		TOTAL 5/	
	Number of Village Projects	Total Amount of Loans	Number of Village Projects	Total Amount of Loans	Number of Village Projects	Total Amount of Loans	Number of Village Projects	Total Amount of Loans		
Assuit	2	LE 67,000-	5	LE 118,000-	2	LE 15,000-	1	LE 18,000-	11	LE 218,000-
Beheira	2	44,000-	7	150,000-	1	9,000-	7	116,500-	17	319,500-
Beni Suef	4	60,000-	1	40,000-	10	93,500-	1	15,000-	16	208,500-
Dakahlia	-0-	-0-	4	75,000-	10	63,000-	1	40,000-	15	178,000-
Demiat	4	76,000-	-0-	-0-	-0-	-0-	-0-	-0-	4	76,000-
Fayoum	-0-	-0-	5	110,000-	-0-	-0-	5	82,500-	10	192,500-
Gharbia	-0-	-0-	10	227,000-	-0-	-0-	3	86,000-	13	313,000-
Giza	4	60,000-	1	30,000-	5	60,750-	1	83,000-	11	233,750-
Ismailia	3	72,000-	3	75,000-	-0-	-0-	1	6,000-	7	153,000-
Kafr El-Sheikh	10	195,000-	6	115,000-	1	15,000-	2	26,000-	19	351,000-
Kalioubia	1	20,000-	5	95,000-	1	6,000-	-0-	-0-	7	121,000-
Marsa-Matrouh	-0-	-0-	-0-	-0-	-0-	-0-	2	30,000-	2	30,000-
Menia	4	124,000-	5	105,000-	2	22,500-	7	105,000-	18	356,500-
Menoufia	5	100,000-	12	256,000-	-0-	-0-	-0-	-0-	17	356,000-
New Valley	1	20,000-	1	20,000-	-0-	-0-	3	33,000-	5	73,000-
North Sinai	1	17,000-	1	13,000-	-0-	-0-	2	30,000-	4	60,000-

Qena	4	LE 54,000-	16	LE 235,000-	2	LE 15,000-	2	LE 45,000-	24	LE 349,000-
Sharkia	2	33,000-	17	343,000-	-0-	-0-	1	15,000-	20	391,000-
Sohag	-0-	-0-	3	50,000-	-0-	-0-	3	15,000-	6	65,000-
	48	LE942,000-	102	LE2,057,000-	34	LE299,750-	42	LE746,000-	226	LE4,044,750-

Explanatory Notes:

1/ Includes cattle and sheep.

2/ Includes broilers and layers.

3/ Transportation of persons and things.

4/ Beekeeping, farm machinery, tile production, fishing vessels, quarry operations.

5/ Villages contributed resources (land, building, labor effort, money) valued at LE1,556,678.

THE DEVELOPMENT DECENTRALIZATION-ONE PROJECT
PROJECT NO. 263-0021
CONTRACT NO. AID/NE-C-1615 WITH CHECCI & CO.
SUMMARY OF U.S. DOLLAR COSTS CLAIMED AND QUESTIONED
APRIL 23, 1979 THROUGH DECEMBER 31, 1981

	Claimed	Questioned
Salaries and Wages	$ 464,766	$77,111 1/
Allowances	104,837	-0-
Per Diem (U.S. & Int'l)	8,034	-0-
U.S. Travel & Int'l Transport of Effects	70,986	-0-
Other Direct Costs	12,859	-0-
Insurance	33,468	-0-
Overhead:		
Field	331,623	-0-
Home Office	11,758	-0-
Short Term Staff	46,267	46,267 2/
Consultants	-	(77,111) 1/
Sub-Total	1,084,598	46,267
Fixed Fee	83,213	3,150 3/
TOTAL	$1,167,811	$ 49,417

1/ Represents reimbursements made to :ependent consultants that were commingled in the salaries and wages line i m. We have reclassified these costs.

2/ Represents the actual sum of overhead reimbursements made based on consulting fees charged.

3/ The contractor's fixed fee billings were based on (i) the total amount billed divided by (ii) the total contract amount less fixed fee ceiling. The :esultant quotient was then multiplied by the fixed fee ceiling. Therefore:

$$\frac{\$46,267}{\$1,367,873} = 0.03 \times \$105,000 = \$3,150$$

BACKGROUND AND AUDIT SCOPE

The Government of Egypt is committed to decentralization of local administration. In 1973, the Organization for Reconstruction and Development of the Egyptian Village (ORDEV) was created within the Ministry of Local Government (Ministry). This agency was charged with modernizing and developing the Egyptian village.

Administratively Egypt is divided into governorates, markaz, towns and villages. Twenty-one of 25 existing governorates in Egypt have rural areas containing about 147 markaz surrounded by over 4,000 villages. Egypt's overall goal is greater integration of these units into the process of development.

In its efforts to expedite the process of decentralization, the Ministry encouraged the establishment of village councils. Village council members are elected and are encouraged to engage in income producing activities. To assist elected village councils in their development activities, a Local Executive Committee was established and chaired by a Head Executive Officer appointed by the Ministry of Local Development. This Local Executive Committee includes representatives from various GOE Ministries posted within the village. The Executive Committee is to assist elected local councils in developing local villages projects and seeing that revenues of the village projects are utilized in the manner decided by the elected local council.

Revenues are deposited into a Local Services and Development Account in each village. In addition to village project revenues, funds for this account consist of receipts from duties, donations, contributions and other funds generated in the villages.

As early as 1973 AID had been looking for a rural development activity in Egypt that would provide entry at the village level into the rural development sector. Beginning in 1976 AID in conjunction with ORDEV initiated a series of studies designed to identify an activity that met this criteria. The Development Decentralization-One (DD-I) Project is one of the results of these studies.

AID's project, effective January 23, 1978, is to assist the Government of Egypt's process of decentralization by strengthening the financial viability and development capability of local administration (selected village councils). The chief component of AID's project is the establishment of a Local Development Fund within ORDEV. This fund is to operate according to sound fiscal and management principals, and will extend loans to village councils for the purposes of establishing income-producing projects. Income generated is recycled into the village Local Services and Development Account, and used for other projects of benefit to the village.

As of December 31, 1981 AID had obligated $26.4 million for the project. This amount included $26.2 million and LE125,000 ($150,000). The project grant agreement was signed on May 29, 1978 to provide funding for the five-year project. Disbursements totalled $9.0 million as shown in the tabulation below.

Financial Status
As of December 31, 1981
U.S. $ Equivalent
($000)

	Revised Budget	Obligated	Disbursed	Unliquidated Obligations
Local Development Fund	$18.6	$ 6.2	$6.2	$ -0-
Technical Assistance	2.8	2.0	1.4	.6
Participant Training, Training and Equipment	3.4	2.3	1.4	.9
Research and Evaluation	.3	-0-	-0-	-0-
Contingencies & Misc.	1.3	-0-	-0-	-0-
Unsub-Obligated.	-0-	15.9	-0-	15.9
	$26.4	$26.4	$9.0	$17.4

Funds for local development are loaned by the LDF to villages for profit making activities such as cattle fattening, poultry production and brick making. At December 31, 1981 there were 226 outstanding loans to villages totalling $5,778,214 (LE4,044,750) as shown in Exhibit A.

Purpose and Scope

The purposes of our audit were to determine whether the project is achieving its stated objectives and is being implemented with requirements of the grant agreement and AID regulations; to evaluate project monitoring; and to ascertain if grant funds were expended properly and in compliance with AID's policies and regulations.

We examined project documents and reports located in USAID/Egypt, the contractor's office in Cairo, ORDEV/LDF offices and selected Governorates, Markaz, and village units. Also, we made visits to project activities in Egypt, and held discussions with appropriate AID, Government of Egypt, and contractor officials.

This initial audit covered the period from May 29, 1978 through December 31, 1981, and was made in accordance with prescribed standards for government audits.

LIST OF REPORT RECOMMENDATIONS

	Page
Recommendation No. 11	14
USAID/E through ORDEV/LDF require that village quarterly financial reports show the disposition of project funds, in order to improve controls by the elected village councils over the use of LDF project funds.	
Recommendation No. 12	18
USAID/E in coordination with ORDEV/LDF make arrangements to reinstate training in financial management for village accountants.	
Recommendation No. 13	18
USAID/E instruct ORDEV/LDF to reconcile, on a periodic basis, cash receipts from village loan repayments to bank deposit statements, and institute a system of reporting to USAID/E.	
Recommendation No. 14	19
USAID/E require ORDEV to determine the value, location, and condition of all equipment procured with project funds, establish an equipment locator system, and furnish a copy of the documentation to USAID/E. USAID/E should recover the cost of equipment that cannot be located.	
Recommendation No. 15	19
USAID/E require Checchi and Company to maintain at their official place of business adequate to financial records to support local currency costs of Grant No. 263-G-80-006; and to obtain the services of a qualified local bookkeeper to keep these financial records.	

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Recommendation No. 16 USAID/E require the U.S. contractor to furnish signed lease agreements for residential housing and office space.	19
Recommendation No. 17 USAID/E and ORDEV/LDF review each of the LDF-financed tile production projects located in the villages of Sandafa El-Far, Agou Gerg, and Shalakam in the Menia Governorate, make a determination whether or not the popularly elected village councils can repay the loans, and take appropriate corrective actions.	21
Recommendation No. 18 USAID/E instruct ORDEV/LDF to reject future LDF loan applications for village cattle fattening projects until the climate improves.	21
Recommendation No. 19 USAID/E collect $46,267 representing overhead reimbursements made to Checchi and Company based on consultant fees, and $3,150 of corresponding fixed fee under Contract No. AID/NE-C-1615 for the period April 23, 1979 through December 31, 1981.	22
Recommendation No. 20 USAID/E determine and recover overhead payments made to Checchi and Company on the basis of consultant fees for the period January 1, 1982 through the present period under Contract No. AID/NE-C-1615.	22
Recommendation No. 21 USAID/E recover LE4,050 ($5,786) representing ineligible procurement of a Zeitor tractor by the village of El-Hagrassa located in the Sharkia Governorate.	23

APPENDIX III

LIST OF REPORT RECIPIENTS

EGYPT

Director, USAID/Egypt	5
Regional Inspector General for Investigations & Inspections (RIG/II/C)	1

AID/WASHINGTON

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 (NE) (Audit Liaison Officer)	1
Bureau for Program and Management Services (SER)	6
Bureau for Program and Policy Coordination	1
Office of Development Information and Utilization (DS/DIU)	4
Office of the General Counsel (GC)	1
Office of Financial Management (FM)	1
Office of Legislative Affairs (LEG)	1
Office of the Inspector General (IG)	1
Office of Policy, Plans and Programs (IG/PPP)	1
Office of Investigations and Inspections (AIG/II/W)	1
Executive Management Staff (IG/EMS)	12

REGIONAL INSPECTORS GENERAL FOR AUDIT

RIG/A/Karachi	1
RIG/A/Karachi--New Delhi	1
RIG/A/LA	1
RIG/A/La Paz Residency	1
RIG/A/Manila	1
RIG/A/Nairobi	1
RIG/A/Washington	1
RIG/A/WA	1