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Auditor General

AUDIT REPORT

on

THE FINANCIAL PROCEDURES AND CONTROLS

of

THE COMMODITY IMPORT PROGRAMS OF EGYPT

AID LOANS NO. 263-K-(026), (027), (029), (030), (036), (038),

(045A), (045B), (052)

and GRANT NO. 263-0119

Audit Report Number 6-263-81-1

Issue Date November 30, 1980

Area Auditor General EGYPT

Agency for International Development

EXECUTIVE SUMMARY

Introduction

At the time of our review, there were nine loans and one grant signed that obligate $1.54 billion for the Commodity Import Program (CIP) in Egypt. A significant part of total U.S. economic assistance to Egypt, the CIP was initiated during 1975 to address the short-term needs of Egypt. To assist Egypt in meeting hard currency costs of imported commodities and commodity-related services as needed, the program is designed to (a) relieve the serious foreign exchange shortage, (b) achieve development objectives, (c) improve the standard of living, and (d) maintain political stability.

Of the $1.5 billion obligated, about 95.5% (over $1.4 billion) has been allocated to Egypt's public sector. The remaining balance, about $68.5 million, has been allocated to Egypt's private sector, and is the subject of AAG/E Audit Report No. 80-10 dated August 10, 1980. This report covers the financial procedures and controls used to administer the CIP public sector funds. A forthcoming report (No. 81-2) will cover the internal operating procedures relative to CIP public sector activities. Also to be issued, a report covering those broad issues applicable to the overall CIP, both public and private sectors, and presenting overall program conclusions, will be assigned No. 81-3. For better perspective, the reader may wish to obtain this entire series of four CIP reports.

Audit Purpose and Scope

We reviewed costs and financial data of the CIP from program inception, February, 1975 through July 31, 1980; for CIP management policies and practices, audit coverage extended from program inception to report issuance. For this review the audit purposes were to: (a) determine and evaluate the methods of financing; (b) review fund disbursements; (c) evaluate the system of accounting for program costs; (d) review and evaluate procedures and controls over specific program transactions, including costs, losses, refunds, advances, payments as well as CIP Loan repayments; and (e) review and evaluate grant counterpart generations.

To accomplish these objectives we examined procedures and systems in place and planned, reports, files, planning and implementing documents, and referred to pertinent Statutes, laws and other criteria. We visited GOE Ministries, agents and public sector firms, involved USAID/E offices, and the Central Bank of Egypt. We also coordinated with the Area Auditor General/Washington (AAG/W) to obtain information generated in AID/Washington and in the United States.

Conclusions

AID's Accounting and Information System for CIP

As currently functioning, AID's accounting and information system for the CI Programs does not provide all the information needed by management for efficient program implementation nor does it have adequate internal controls to prevent misuse. Controls over computer transactions and program information are not adequate to prevent incomplete, inaccurate, or duplicative feed-ins and, consequently, unreliable output reports. Information at the USAID/E and in AID/W reporting contain numerous differences in dollar amounts obligated. AID/W reports of disbursements have not been timely and accurate for controlling local currencies generated under CIP grant assistance. The system does not reach the Letter of Credit level; therefore, the needs of USAID/E--as prime program manager--are not being addressed. Since computer system problems are not within the control of USAID/E, we have informed the Area Auditor General in Washington (AAG/W) and anticipate that a review of this area will be scheduled (page 5).

Methods of Financing

USAID/E policies and practices in determining methods of financing for CIP activities need to be reassessed. In actual operations USAID/E practices do not comply with the most current "Cash Management Procedures" of AID which prescribe Agency policy on the use of Direct Letters of Commitment (Direct L/Coms) in preference to Bank L/Coms. AID's Cash Management Policy guidelines were approved by the Deputy Administrator on November 21, 1978. In the past, the USAID/E and the COE have placed heavy emphasis on the use of Bank L/Coms in the CIP; this practice is being continued at the present time, even when large scale bulk commodities and/or large volume of capital equipment are bought from a single supplier. As a result, Agency Policy is not being carried out and the controls inherent to the Direct L/Com method of financing are not implemented, increasing the Agency's risk factor in disbursing multi-million payments under this program. Also, considerable sums of CIP assistance monies are spent on bank charges and interest which are unnecessary under Direct L/Com procedures. We calculated that bank charges of about $566,000 could have been saved in some selected transactions included in the audit review period. We are recommending procedures be established to carry out current Agency policy and to select the most effective financing method for each procurement (page 8).

Advances and Progress Payments to Suppliers

Regulations and AID policy make a distinction between "Advances" and "Progress Payments" to suppliers. Advance payments are made without reference to work progress and should not exceed 10% of the total cost of a contract. Progress payments are made on the basis of costs incurred or percentage of completion of work accomplished. Our review disclosed that significant amounts of money have been paid to suppliers under the CI Program either as advances which exceed the 10% limitation or as progress payments which are not truly based on percentage of completion and which can be classified as further advances.

To illustrate, three suppliers sampled in our review received in total $14 million in advance or "progress payments" against total contracts of $38 million. There are two causes for these conditions: (a) ambiguity of the regulations, and (b) an absence of necessary AID and USAID/E systems, procedures and practices that ensure that advances and progress payments meet established criteria. As a result, the USAID/E may not be following regulations and the practice is costly. The U.S. Government, although not a direct party to these contracts between the Host Government and the suppliers, incurs unnecessary administrative expenses and high interest costs on funds borrowed by the U.S. Treasury. At the same time, suppliers hold and use huge sums of public funds for lengthy periods of time. We are recommending that procedures be established to assure proper approvals of and controls over CIP advance payments; also, that applicable regulations and Handbooks be reviewed and classified, as necessary (page 14).

Rates of Disbursements

The rate of disbursement is an important factor in the CIP because this non-project assistance is intended to address short-term economic needs of host countries and improve their Balance of Payment positions. To achieve these program objectives of the CIP, obligated funds should be disbursed reasonably fast and have a positive impact on the economy.

The rates of disbursement under the CIP can be improved by establishing systematic procedures to identify fully completed transactions, thereby enabling USAID/E management to immediately reprogram unused balances excess to actual costs but remaining committed under issued Letters of Credit. These unused balances are "lost" in the system and unavailable for use by the GOE until they are identified and reprogrammed for other valid needs under the CIP. Under a continuing-basis computer system, as we recommend, these "lost" funds could be identified early and reprogrammed for GOE use under the CIP without the need to extend TDDs. Administrative costs should be reduced substantially. We are also recommending that USAID/E review idle balances of over $.95 million and deobligate those amounts wihtout valid, existing liabilities (page 20).

Commodity Losses

Quarterly reports continue to accumulate commodity losses now totaling $3.1 million but no effective actions have been taken by the responsible action officers. USAID/E operating managers in the CIP need to identify and pursue those losses that are recoverable and collectible. USAID/E Controller records and loss reports should be adjusted and maintained to accurately reflect recoverable losses based on CIP management determinations. Procedures should be effected for continuing monitoring of losses and appropriate follow-up action. We are recommending actions directed at improved procedures and reduced administrative costs (page 25).

Local Currency Counterpart Generations

AID Grant No. 263-0119, dated August 29, 1979, provided $85 million in assistance through the CIP and requires that the GOE deposit into a Special Account local currencies equal to about $70 million in proceeds accruing under the grant. Grant Implementation Letter No. 4, issued by the USAID/E on April 15, 1980, sets forth procedures with regard to establishment of this Special Account and use of the GOE "Set Aside". Deposited funds are to be used for purposes mutually agreed upon by AID and the Grantee. Planned uses of these funds can significantly benefit the United States, AID and USAID/E operations, the GOE, and the AID program in Egypt.

Although USAID/E records show activity under this grant as early as February 1980, effective controls over substantial local currency funds generated under this grant have not yet been applied by the USAID/E. Primary causes are: (a) USAID/E delayed implementing procedures regarding establishment of the Special Account and in monitoring activities therein; (b) AID/W has not furnished the USAID/E with timely or accurate Report W-214 data to enable notification to the GOE of required deposits; (c) the GOE has not furnished the USAID/E with required bank statements containing a record of deposits, withdrawals, and balances; and (d) the USAID/E did not determine activity and status of the Special Account in the absence of GOE statements.

In view of these circumstances, the audit team scheduled an examination of GOE procedures, activity, and status of the account; but this examination was delayed because access to the account was not granted for over five weeks, causing a further delay in obtaining and verifying account information. We are recommending controls and procedures be established through mutual agreement with GOE officials and the Central Bank of Egypt; also, that existent requirements for monthly account information be enforced (page 27).

Agents' Commissions

The USAID/E has made a decision, which was apparently concurred with by AID/W, to finance agents' commissions of CIP transactions as U.S. Dollar costs rather than as local currency costs. There have been questions raised during the last five years about this practice for two basic reasons: first, the practice reduces the value (estimated at $44.2 million) of actual commodity imports into the Egyptian economy; and second, the USAID/E has an inconsistent posture on this issue. In the case of capital projects, the USAID/E refuses to finance agents' commissions as an operating rule and these costs are financed with local currency; yet, the USAID/E permits U.S. Dollar cost financing under CIP. In addition, the USAID/E, in its response to our draft report, introduced the fact that the practice extends into other areas aside from the CIProgram. For this reason, and in order to more fully consider the subject in a broader perspective, we decided to include our discussion of the issue and available facts known to us in Audit Report No. 6-263-81-3, entitled "An Overview of the Commodity Import Programs of Egypt," which will be issued o/a January 10, 1981 (page 35).

Recommendations

This report contains 10 recommendations listed in Appendix II.

INTRODUCTION

1. Description of the CI Program

Since resuming diplomatic relations with Egypt, in 1973, the U.S. Government has been providing assistance programs which are directed towards promoting economic and political stability of the country. From a development point-of-view, AID has followed, according to stated policy documents, an economic strategy which encompasses dual objectives:

(a) to maintain a large net inflow of U.S. and other foreign resources in the short-run; and,

(b) to achieve a lower need for foreign resources inflows over the medium and long-run through expansion of Egypt's productive capacity.

Two of AID's programs, the Commodity Import Programs and the P.L. 480 Programs, are designed to address the short-term needs of Egypt. The medium and long run requirements are being addressed through numerous bilateral projects and programs.

This report limits its coverage to the Commodity Import Program (CIP) and more restrictively to the financial procedures and controls used in the different phases and systems of the program. Background information on the CIP is treated in greater detail in Appendix I.

In brief, there have been nine CIP loans and one grant signed since 1975 when economic assistance was initiated. Through the time of the audit, these agreements obligated $1.54 billion for the CIP. The funds are appropriated through the Economic Support Fund (ESF) as authorized under Section 532 of the Foreign Assistance Act (FAA).

Of the total $1.54 billion obligated funds, about $1.472 billion was allocated to Public Sector organizations (Ministries and Agencies) of the GOE. A small portion ($68.5 million) was allocated to the Private Sector to encourage free enterprise and private participation as part of AID's continuing commitment to comply with the intent of Section 601 of the FAA. Reviews have been made covering the procedures used in managing the funds processed by both the Public and Private Sectors. The results of this comprehensive CIP audit coverage are being reported in series. For better perspective, the reader may wish to obtain this entire series of four reports, identified below.

Audit Report No.	Date of Publication	Title
6-263-80-10	August 10, 1980	The Private Sector Allocations of the Commodity Import Programs of Egypt.
6-263-81-1	November 30, 1980	The Financial Procedures and Controls of the Commodity Import Programs of Egypt.
6-263-81-2	o/a December 15, 1980	Internal Operating Procedures of the Public Sector Allocations of the Commodity Import Programs of Egypt.
6-263-81-3	o/a January 10, 1981	Overall Issues and Conclusions on the Commodity Import Programs in Egypt.

Exhibit A shows the breakdown of CIP loans and grants with allocations, as approved by the GOE. The figures in Exhibit A, and in other Exhibits appended, should not be considered a measure of actual CIP expenditures. To illustrate, under Agency accounting definitions, disbursements include advances; but, advances are not actual expenditures. The report section covering advances and progress payments (page 14) adds perspective on this. The accounting and information system section of this report (page 5) addresses difficulties encountered during the audit in attempting to determine the actual disbursement and expenditure status of these CIP allocations. Related, specific situations will be covered in AAG/E Audit Report No. 81-2. Those inter-related areas involving disbursements and expenditures, and affecting overall CIP country objectives, will be addressed in AAG/E Audit Report No. 81-3.

This report covers the financial procedures and controls used in the series of actions which take place in a CI Program from the time the funds are obligated by agreements to the time the principal amount is repaid by the host country. These actions include the following:

(1) Accounting and information system operations.

(2) A determination on and use of the methods of financing.

(3) Disbursement of funds for the following purposes:

procurement of commodities; advances to suppliers; progress payments; agents' commissions; bank charges; freight/demurrage costs; and other related program costs.

(4) Expediting rates of fund disbursement for maximum benefit to the economy and Balance of Payments position of the host country.

(5) Deposits of required local currency into the special counterpart account.

(6) Filing of insurance losses.

(7) Request for refunds.

(8) Payment of interest at rates stipulated in the agreements.

(9) Repayment of principal amounts for AID.

2. Scope of Audit and Purpose

This is the second audit report by the AAG/E of the CIP. The series of four reviews contribute, individually or collectively, towards attaining comprehensive audit objectives listed in Appendix I. For this review, our audit objectives were: (a) determine and evaluate the methods of financing; (b) review fund disbursements; (c) evaluate the system of accounting for program costs; (d) review and evaluate procedures and controls over specific program transactions, including costs, losses, refunds, advances, payments as well as CIP loan repayments; and (e) review and evaluate grant counterpart generations.

Our examination covered the procedures used by the USAID/E, AID/W, the GOE and, to a very limited extent, the Central Bank of Egypt. The period covered in this audit was from program inception February, 1975, to July 31, 1980 for financial data. CIP management policies and practices were reviewed up to report issuance. Although our examination placed emphasis on procedures in effect at the most current time, historical transactions were examined to gain perspective and to analyze origins of problems. The review was conducted in accordance with sound auditing principles and standards. Accordingly, we examined, to the extent deemed necessary, historical files, computer runs produced by AID/W, transaction support data, cables, correspondence, disbursement data, arrival accounting information, related files, and pertinent statutes, regulations and other criteria. We visited various GOE Ministries, public sector firms, the Central Bank of Egypt, agents of importers, agents of suppliers, and involved USAID/E offices. We also held meetings and interviews with various officials and employees of GOE entities and with cognizant managers and involved USAID/E personnel, including top USAID/E management.

We coordinated with the Area Auditor General, Washington (AAG/W) to obtain information generated in AID/W and the United States.

3. USAID/E Comments

The USAID/E was furnished the draft of this report and two extensions of time for comments were agreed to by the AAG/E. We were advised that the report raised fundamental issues which the USAID/E found difficult to resolve within the extended time frame. During processing and assembly of the final report, we received a draft response from the USAID/E and considered these comments during final report assembly. While these comments are considered herein, they are of an interim nature and indicate the USAID/E is completing further internal study on several issues which will result in more comprehensive comments in response to this final report.

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

1. AID's Accounting and Information System for CIP

As currently functioning, AID's accounting and information system for the CI Programs does not provide all the information needed by management for efficient program implementation nor does it have adequate internal controls to prevent misuse. Controls over transactions and program information are not adequate to prevent incomplete, inaccurate, or duplicative feed-ins and, consequently, unreliable output reports.

The Agency makes extensive use of the computer as a source of its information system and to account for obligations and expenditures under CI Programs in Egypt and around the world. During the audit, we requested five different profiles of the disbursements reflected in the computer memory for the CIP loans of Egypt. We were not able to get the information as needed because the system does not have a query feature; it stores information, but management cannot request information on composition of individual transactions or characteristics of groups of items. The system reaches the Letter of Commitment level, but not the Letter of Credit level; this latter level is the one most needed by first line management--USAIDs.

At our request, Data Management extracted from the central system six computer runs (referred to as Reports 1-6) presenting this information in three different profiles.1/ This is valuable information, but the reports reflect a series of potential problems, seemingly procedural in nature, involving both internal and external computer operations. For this reason, we are recommending that AG offices in Washington undertake a special review of this aspect of the CIP around the world. Here are some examples of problems disclosed by these statistical profiles:

A. The various computer runs, used to compile our statistics, do not agree on the total disbursements. Three reports show disbursements totalling $919,146,824. Two reports show $918,833,435. The "Monthly Status Report" shows $876,020,054. Thus, there is a potential error factor representing over $43 million. The reason(s) for the difference must be determined.

B. Individually recorded, and identical transactions show unexplained differences. Examples shown in two reports:

1/ Disbursements by Supplier - Reports 1 and 2
Total disbursements by supplier - Report 3
Disbursements by Disbursing Authorizations - Reports 4 and 5
Report of Expenditure by Commodity - Report 6

Voucher No.	Report 5 Page	Report 5 Amount	Report 6 Page	Report 6 Amount
9201436	46	$ 33,495	113	$ 33,475
9201164	64	595,275	113	594,668
9202252	73	2,386,251	113	2,383,844

C. There seems to be a lack of supervisory management procedures to ensure proper coding of information for processing into the computer memory; e.g., suppliers and commodities. At present, accounting personnel are not taking the time to identify and code properly; consequently, computer reports are not reliable. For instance, the statistical profiles show that suppliers with "No Name" received $73,026,440 of total disbursements and suppliers with "No Code" received $52,979,823. In reality, many such coded transactions could have been properly identified. Here are some additional examples: Report No. 1, page 4, shows a transaction under Voucher 6606145 for $1,879,464 to a "No Code" supplier; according to Report 6, the commodity is "Tallow"; and according to Report 1, most of the Tallow is being supplied by Pasternak Baum Corporation (Supplier Code No. NY 1326)--Page 21 of 1 shows a series of transactions under Loan 029-04 which total $1,992,320 against a "No Code" supplier; the commodity code is "Motor Buses" which are being provided by Supplier No. AR 30 or "Ward Industries Inc.";--Page 345 of Report 1 shows a series of transactions paid to "No Name" which total $9,501,195; this again is "Tallow" being supplied by Pasternak Baum Corporation. In other words, minor crosschecks by the coder could have identified the supplier.

D. Report 6 shows a series of "Special Vouchers" which appear to be adjustment entries into the computer; many times these are offsetting entries, but in several cases, cost data may be affected; e.g., Page 10 $1,471,879. The Special Voucher transactions are not shown on Reports 4 or 5. Assist work by the AAG/W could not determine the nature and purpose of these entries; i.e., no vouchers could be located nor any explanations. We do not know what this $1.4 million represents; i.e., neither supplier nor commodity is identified.

E. The financial profiles show that $13,779,618 represent advance commodity financing (Page 113 of Report 6). These are advances to suppliers. USAID/E does not maintain any control records to account for these advances. According to Report 1, these advances have been made to "No Code" suppliers. The subject of Advances is treated as a separate section of this report.

F. On the surface, some bank charges seem excessive and in any event greatly exceed the prevailing composite averages. Some examples shown in Report 6: $27,042 (page 84); $23,215 and $23,215 (page 103)

--also possible duplicates; $16,022 (page 104); $14,185 and $13,626 (page 105); and $44,527 (page 82). According to the AAG/W, there was a period of time when banks were not processing documents as expeditiously as possible, this then accounted for the exhorbitant costs.

G. Page 36 of Report 1 shows a series of five individual transactions ($423,946; $10,530; $165,794; $4,364; $395,366) which total exactly $1,000,000. These were paid to a "No Coded" supplier. Our attention is drawn to the exactness of the total and the fact that the supplier receiving payment is unidentified.

H. Report 6, showing expenditures classified by commodity, also includes advances and progress payments. Advances, of course, are not true expenditures. While progress payments would normally be valid expenditures, representing status of work completed, many are actually disbursed without linkage to work completed or actual costs incurred; such payments are, in effect, advances. This subject is discussed in detail under the following report section by that title. This subject will also be covered from various aspects, in Audit Reports No. 81-2 and 81-3 (See page 2).

I. Other transactions examined during our audit lend further support to the conclusion that improvements are needed in the accounting and information system for the CIP. Some examples follow:

- Report W-214, AID Non-Project Assistance Transaction Detail of Loan and Grant Activity, furnished the USAID/E has not been timely and has shown inaccurate disbursement information relative to CIP Grant No. 263-0119. As a result, USAID/E has been unable to take required actions on Special Account deposits by the GOE. A detailed discussion of this situation begins on page 27.

- During our examination of CIP transactions at the USAID/E, we found USAID/E records and data sheets understated disbursements for edible oil by $7 million.

- During our review of methods of financing used in the CIP, Report W-214 data and USAID/E data were found to contain numerous differences in dollar amounts obligated. Data included in the report section beginning on page 8 is based on the Report W-214 information.

Conclusions

In sum, AID's accounting and information system is not functioning the way it should. It does not have a query feature; consequently, information is stored, but queries and questions on individual transactions cannot be retrieved from the computer. Exception reports identifying potential problems are not, to our knowledge, being produced and used by management; thus, possibilities for payment duplications, for example, exist. The system does not reach the Letter of Credit level; therefore, the needs of USAID/E--as prime program manager---are not being addressed.

While the computer runs furnished us present a different format than other users might need, the information therein is extracted from the same CIP computer system in AID/W. Based on these computer runs, input data for identical transactions appears to be from different sources because output figures disagree for the same voucher transactions.

Clerical and coding tasks are not being controlled by either Data Management or the Office of the Controller; consequently, incomplete information is fed into the computer and the output reports are unreliable. Controls over advances are not clear and duplication of costs is possible. Internal controls over information within the computer are inadequate; for example, in a 1976 survey of the Office of the Controller, we found that the computer was being misused through at least two different methods, demonstrating the urgency and need for adequate safeguards to reduce risk in this area.

Computer system problems are not within the control of USAID/E. They are at the Washington level and the examples reflected in the statistical profiles of Egypt are indicative, in our opinion, of a worlwide condition. We have informed the Area Auditor General in Washington (AAG/W) and anticipate that a review of this area will be scheduled in the future. No recommendation is therefore made.

Until improvements can be made in AID's accounting and information system for the CIP, it is incumbent upon USAIDs worldwide to more closely monitor CIP funds and activities. For the USAID/E, effective management and monitoring of the largest CI Program in the world is even more critical. Succeeding sections of this report address areas where management improvements can be made by both AID/W and USAID/E.

2. Methods of Financing

The Agency has established policies and issued implementing procedures covering cash management. These policies and procedures are set forth in AID Handbook 15 and, more recently, in "Cash Management Procedures" as transmitted in State cable no. 273219, including references therein. Also, related criteria are contained in AID Regulation 1.

This report section addresses USAID/E effectiveness in carrying out Agency Cash Management policy relating to methods of financing. Those Cash Management procedures relative to advances and progress payments to suppliers are discussed separately in the next following report section.

USAID/E policies and practices in determining methods of financing for CIP activities need to be reassessed. In actual operations, USAID/E practices do not comply with the most current "Cash Management Procedures" of AID which prescribe Agency policy on the use of Direct Letters of Commitment (Direct L/Coms) in preference to Bank L/Coms. AID's Cash Management Policy guidelines were approved by the Deputy Administrator on November 21, 1978. In the past, the USAID/E and the GOE have placed heavy emphasis on the use of Bank L/Coms in the CIP; this practice is being continued at the present time, even when large scale bulk commodities and/or large volume of capital equipment are bought from a single supplier. As a result, Agency Policy is not being carried out and the controls inherent to the Direct L/Com method of financing are not implemented, increasing the Agency's risk factor in disbursing multi-million payments under this program. Also, considerable sums of CIP assistance monies are spent on bank charges and interest which are unnecessary under Direct L/Com procedures. We calculated that bank charges of about $566,000 could have been saved in some selected transactions included in the audit review period.

A complete description of the four most common AID methods of financing is included in Chapter 9 of AID Handbook 15. The following brief description comes from State Telegram No. 273219 dated October 19, 1979 which provides Cash Management Procedures, for implementation of Agency policy:

> "Direct Reimbursements: AID reimburses the borrower/grantee for payments made. This method of financing gives AID an opportunity for full review of the transaction before AID funds are disbursed.
>
> Direct letter of commitment: AID issues direct letters of commitment to suppliers and contractors and makes payments directly to them on receipt of invoices and supporting documentation. The direct letter of commitment method permits AID to review documents before making payments and avoids bank charges incurred through use of bank letters of commitment.
>
> Bank letters of commitment: The bank letter of commitment method utilizes established commercial banking channels to process payments to suppliers and contractors. The bank L/Comm method of financing can be used for all dollar procurement of equipment, materials and services under project assistance and is the usual method under commodity import programs, except in the case of large volume purchases from a single supplier.*
>
> Direct payments: Contracts, purchase orders and grant agreements may include language which provides for direct payments by AID without additional commitment documents."

*Note: (Bank L/Com procedures, quoted above, do not require administrative certification by a knowledgeable AID project officer to assure the propriety of payments.)

AID Handbooks cover these financing methods in-depth and provide detailed guidance on the prudent internal control procedures required when Direct L/Com financing is used. However, prior to issuance of current policy guidelines, AID regulations governing host country (B/G) contracting did not give high preference to the Direct L/Com method of financing. But, following past Auditor General reports on B/G contracting policy and implementation, some Handbook revisions were made. High preference is given the Direct Reimbursement (when Host Governments are capable of operating under this method) and Direct L/Com methods. AID Handbook 15, issued in September, 1979, covers CIP guidance and states that Direct Reimbursement is the preferred method of financing "...for all types of assistance provided that a determination has been made that the B/C possesses the managerial and financial capability to operate under that procedure..." As approved in late 1978, Agency policy has placed preference on the Direct L/Com method. Pending revision of all pertinent Handbooks, basic procedural guidance for this policy was set forth in the October, 1979, "Cash Management Procedures" of the Agency. These procedures provide, in part:

"Careful consideration should be given to the selection of the method of financing covering any given procurement action. The direct letter of commitment method is particularly appropriate and generally preferable to bank letters of commitment for borrower/grantee service type of contracts. High bulk commodity shipments and for any type of transactions when it is necessary or advisable for AID to review documentation before making payments. AID can frequently assume a limited additional administrative burden through performing the banking function and in return, substantially reduce banking charges otherwise absorved as project costs. Conversely, bank letter of commitment should be used if project implementation will produce a profusion of invoices for small amounts. In the latter instance it may be assumed that the cost to AID of assuming the added administrative burden would exceed the related banking charges."

Beginning in October, 1979, then, the USAID/E should have established policies and practices to comply with Agency policy. But, USAID/E policies and practices have not been changed to keep pace with and carry out overall Agency policy. The USAID/E has continued predominant use of Bank L/Coms in the CIP after approval of the current policy in late 1978 and after issuance of AID cash management procedures in October, 1979.

Our review of the $1.54 billion CIP obligations through nine loans and one grant (See Exhibit B for details) covers USAID/E financing practices from program inception in 1975 through July 31, 1980. As shown below in summary, CIP financing has been predominantly through the Bank L/Com method for the entire period.

Method of Financing	Amount In US $ (000)	Percentage
Bank L/Com	$ 1,441,749	93.7 %
Direct L/Com*	85,288	5.5 %
Other (Includes Direct Reimbursements)	12,963	.8 %
Total Program	$ 1,540,000	100.0 %

* Of this total $85.288 million through Direct L/Com financing, $46.0 million applies to one procurement--the WARD BUSES; accordingly, all other Direct L/Com activity totals $39.288 million or about 2.5% of the CI Program.

Since the summary figures above cover the entire program period, we reviewed those CIP loans and grants with activity after October 1, 1979, to determine USAID/E financing practices under current Agency policy. As shown below, the USAID/E has continued the heavy use of the Bank L/Com method of financing:

Method of Financing	Amount In US $ (000)	Percentage
Bank L/Com	$ 309,874	92.7 %
Direct L/Com	20,204	6.0 %
Other (Includes Direct Reimbursements)	4,300	1.3 %
	$ 334,378	100.0 %

The high potential for use of Direct L/Com financing in the CIP is illustrated by our review of some selected transactions as discussed below. At least $354.2 million of past CIP transactions could have been financed through Direct L/Coms because the majority of commodities were either large bulk purchases from single suppliers or costly one-time capital equiment procurements. Some examples follow:

Bulk Commodities:

Supplier	Commodity	US $ 000
Cargill	Corn, Tallow, ...	$ 52,779
Pasternak Baum	Tallow, Edible Oil ...	54,483
Gersony Strauss	Tallow ...	37,324
Special Steel	Tinplate	18,098
Alla-Ohia	Coking Coal	39,047
Goldkist	Frozen Poultry	22,005
	Sub-Total	$ 223,736

Capital Equipment:

Mack Trucks Inc.	Trucks & Trailers	$ 20,600
Aydin Monitor	Traffic Control Centers	9,691
Raytheon Inc.	Micro-wave systems I & II	31,900
Massey Ferguson	Agr. Tractors	17,200
Paccar Co.	Trucks & Trailers	28,750
Salem Furnaces Co.	Rotary Hearth Furnace	5,671
Ailtech A Cutler Hammer	Navigational Control	16,610
	Sub-Total	$ 130,422
	Total	$ 354,158

These $354.2 million in CIP transactions represent a limited review of selected commodity imports which fall within criteria set in current Agency policy and cash management procedures for Direct L/Com financing. There are very probably other commodity imports which could have been financed through Direct L/Coms with additional savings. For example, in addition to those selected transactions shown above, about $590.0 million of high volume bulk commodities and $6.4 million of capital equipment were also imported. We calculated that financing of these selected transactions ($354.2 million) through the Bank L/Com, rather than the Direct L/Com procedure, resulted in about $566,000 spent for bank charges, which could have otherwise been used for program needs. The $566,000 savings in bank charges (calculated at .16 of 1%) does not include interest. There is no ready basis to estimate interest savings; on page 6 of this report, item F shows large bank costs which include interest although the accuracy of the AID information system reduces the usefulness of this data.

Pertinent here, there have been two new CIP loans and one grant totaling $335 million after the audit period. This brings the total program up to $1.875 billion ($1.540 + .335). If this high use of Bank L/Com financing continues through these new hundreds of millions, those benefits accruing under current Agency policy will not be realized; e.g., the internal controls inherent to the Direct L/Com method of financing will not be implemented, thereby increasing the Agency's risk factor in disbursing these multi-million dollar payments under this expanding program; the Agency may not be in compliance with applicable U.S. Treasury regulations as required; and, considerable savings of bank charges and interest will be lost. For the total CI Program to date ($1.875 billion), at 93.6% ($1.7542 billion), assuming the rate of Bank L/Com financing holds constant, bank charges at .16 of 1% would amount to $2,806,720, a substantial amount of potential savings. This does not include any extra interest charges.

Conclusions and Recommendations

Financing CIP transactions through the Direct L/Com procedure, in line with guidance in the most recent Agency policy, has significant benefit to the Agency, primarily in control over payments to assure contract performance. More control will be exercised by the Agency, thus reducing risks of unauthorized, improper or duplicate payments. For instance, when a transaction is financed under the Bank L/Com, the documents are presented by the supplier to the L/Com Bank. Before making payments to suppliers, the U.S. banks review documents submitted for consistency with the term of the L/Com. The L/Coms specify the banks' responsibilities, but generally, according to AID officials, the banks only verify that the correct documents are submitted. They do not verify the accuracy of the documents. Thus, SER/COM must still make complete post-audits; according to AID/W, SER/COM is currently making 100% post reviews of payments, even though incurring bank service charges. Under the Direct L/Com procedures, such costly bank charges and interest are saved. Beyond this, compliance with Agency policy and procedures would assure compliance with U.S. Treasury Department regulations, as required.

In sum, we believe the Direct L/Com method of financing can be effectively used in the case of the CIP Egypt program, in instances where bulk commodities and costly project-like or capital equipment is involved. This procedure, if properly applied will enable better USAID/E control over multi-million dollar payments, reduce the Agency's risk factor, and will be cheaper in the long run.

Recommendation No. 1

USAID/E establish procedures to (a) carry out Agency policy set forth in State telegram 273219; (b) review and evaluate each procurement transaction to determine the most effective financing method; and (c) document and record the results of each review.

The USAID/E has given this issue attention at top levels of management and has initiated a fundamental reassessment of Mission practices and policies.

3. Advances and Progress Payments to Suppliers

Regulations and AID policy make a distinction between "Advances" and "Progress Payments" to suppliers. Advance payments are made without reference to work progress and should not exceed 10% of the total cost of a contract. Progress payments are made on the basis of costs incurred or percentage of completion of work accomplished. Our review disclosed that significant amounts of money have been paid to suppliers under the CI Program either as advances which exceed the 10% limitation or as progress payments which are not truly based on percentage of completion and which can be classified as further advances. To illustrate, three suppliers sampled in our review received in total $14 million in advance or "progress payments" against total contracts of $38 million. There are two causes for these conditions: (a) ambiguity of the regulations, and (b) an absence of necessary AID and USAID/E systems, procedures and practices that ensure that advances and progress payments meet established criteria. As a result, the USAID/E may not be following regulations and the practice is costly. The U.S. Government, although not a direct party to these contracts between the Host Government and the suppliers, incurs unnecessary administrative expenses and high interest costs on funds borrowed by the U.S. Treasury. At the same time, suppliers hold and use huge sums of public funds for lengthy periods of time.

Regulation No. 1 prescribes certain limitation on both types of payments; Section 201.25 of this regulation is quoted below:

> "Advance or progress payments prior to shipment may be made with AID funds if the procurement involves any commodity made to the special specifications of the importer and if prior written approval to make such payments has been obtained from AID by the importer, through the borrower/grantee, or if such payments are authorized in the implementing document. Any request for AID approval may be submitted either to AID/W or to the USAID for transmittal to AID/W. AID/W will consider such request only if (a) The total purchase price exceeds $200,000; (b) The initial advance, if any, does not exceed 10 percent of the total purchase price; (c) Each progress payment is at least 10 percent of the total purchase price; (d) The total of all payments prior to shipment does not exceed 80 percent of the total purchase price; and (e) The borrower/grantee or AID requires the supplier to establish in favor of the borrower/grantee a performance guaranty or prepayment bond."

The wording of this section is subject to different interpretations. In response to our draft report, the USAID/E singled out the clauses related to the 80% and the requirements of a performance guaranty or bond and, in part, stated "...This is an area of Agency policy that has not been clearly defined and which is particularly difficult as one looks at project-like activities." The quoted section of AID Regulation 1 does become a little clearer when interpreted in conjunction with the definitions of advances and progress payments contained in Chapter 9E2 of AID Handbook 15, quoted below:

"(a) Advance payment means any payment to a supplier under a contract made prior to, or without reference to, progress on the completion of the performance of the contract."

"(b) Progress payment means any payment to a supplier under a contract, made as work progresses under the contract upon the basis of costs incurred or percentage of completion accomplished."

AID Cash Management Procedures stated in a State 273219 dated October 1979 serve as basis for implementation of Treasury Fiscal Requirements Manual (TFRM 6-8000). This TFRM defines advances as payments made before delivery of goods and for anticipation of future costs. It further states that "...it is the responsibility of Agencies to monitor the cash management practice of their recipient organization to ensure that Federal cash is not maintained by them in excess of immediate disbursement needs." And, further, "Agencies will establish such systems and procedures as may be necessary to assure that balances are maintained commensurate with immediate disbursing needs." AID has been advised that the term "immediate disbursing needs" .... "may be assumed to be cash requirements for as much as thirty days from the date the recipient receives the advance until it is expended."

While the 30-day criteria may be exceeded, "...in unusual instances when the AID Mission or office has established that project implementation will be interrupted or impeded ... AID expects that judgment will be applied by USAID Controllers, contracting officers, and others in determining the immediate disbursing needs of specific recipients."

The overriding theme of the Agency's cash management policy (in State 273219) is directed at ensuring that Federal cash advances are not in excess of immediate need: that controls be implemented to assure no excess advances, that advances are based on documented plans for use; and that funds advanced be, in fact, promptly disbursed for approved project or program costs.

However, AID policy has been that advance or progress payments may be agreed upon, under Host Country (H/G) contracts, when such payments are a necessity for delivery or performance. But, our review showed that actual procedures followed by USAID/E and AID/W did not fully comply with applicable U.S. Treasury Department requirements nor with the Agency's own policy reflected in its Cash Management Procedures. Contractors' proposals for cash advances were not effectively reviewed by USAID/E nor could we locate any evidence that AID/W had either approved these advances, as required, or had given approval to USAID/E actions. This, in our opinion, created a situation where advances to suppliers, such as the three that follow, were $10.14 million in excess of that authorized by regulations:

Comparison of Actual Payments with Advance Limitation
as of July 31, 1980 (in $ millions)

Contractor	Contract Ceiling	Actual Advances 1/	Advances Based On 10% Limit	Immediate disbursing needs (30 days)	In excess of 10% limit
AYDIN	$ 9.69	$ 5.84	$ 0.97	UNK	$ 4.87
AILTECH	16.61	3.32	1.66	UNK	1.66
RAYTHEON	11.92	4.80	1.19	UNK	3.61
TOTAL		$ 13.96			$ 10.14

1/ Includes advances labeled as "progress payments" but that were not evidenced by performance or incurred cost factors.

The lack of effective review by USAID/E and absence of required approval by AID/W is illustrated in pertinent cases discussed in following paragraphs. We believe these examples demonstrate basic lack of controls under CIP funding of project-like activities as compared with funding controls implemented under non-CIP project procurement and review procedures.

Aydin Monitor System

A contract initially totaling $9.69 million was signed between Aydin Monitor System and Egyptian Railway System for the construction of a Railway Traffic Control System (RTC System). The terms of the contract authorized a 10% advance payment and 50% payment after the completion of a site survey. Cable traffic indicates that, in May 1979, the USAID/E strongly recommended the terms of the contract to AID/W. AID/W approved the 10% advance but made no reference to (or approval of) the 50% partial payment. As of July 31, 1980 AID had disbursed $5.84 million although no equipment had yet been shipped. Regardless of the terminology used to describe this sizeable multi-million dollar payment, it is not a progress payment because no equipment had yet been shipped nor had the contractor yet incurred any known costs in the actual construction of the equipment. In our opinion, the $5.84 million represents an advance payment equalling 60% of the contract price unless the site survey equates to 60% of total contract costs; if so, the site survey would seem expensive at almost $6 million and highly disproportionate to total contract costs; based on the $9.69 million total contract price, this would leave less than $4 million for the required construction of the system. There was no apparent basis upon which the $5.84 million could be determined to be commensurate with meeting the 30-day "immediate disbursing needs." We could locate no explanation or justification for these high advance-type payments in USAID/E files. On the basis of known facts, it appears that this contractor received cash payments excessive to needs. With almost $6 million cash in hand, the contractor would be in a position to gain sizeable "windfall" interest income before procurement of project equipment. The size of this advance seems to place the GOE at unnecessary risk;

i.e., while files do show a letter of advance payment guarantee was executed, it only covers 60% of the $5.84 advanced as compared with the total $9.69 contract. The potential for further advance payments without any change in progress or performance under this contract indicates the need to strengthen USAID/E and AID/W contract review procedures. To illustrate, on August 3, 1980, the USAID/E approved an amendment which provides an increase in the contract budget from $9.69 to $13.3 million; since payment terms are unchanged, the contractor can legally request increased advance payments, under stipulated percentages in the contract up to $7.9 million before even one single piece of equipment is constructed and furnished. In our opinion, the $7.9 million would also represent an advance payment equalling 60% of the latest contract cost unless the "site survey" costs were now equivalent to $7.9 million. It would not be a progress payment unless the contractor could demonstrate that equivalent costs had been incurred in the actual construction of the equipment.

Ailtech A Cutler Hammer

A contract totaling $16.6 million was signed between Cutler Hammer and the Suez Canal Authority (SCA) for the construction of a vessel navigational system for the Suez Canal. The contractor received a 20% advance payment totaling $3.32 million in accordance with the terms of the contract. SER/COM files did not provide any justification for exceeding the 10% limitation nor any information supporting a review and conclusion that $3.32 million was commensurate with immediate disbursing needs.

Raytheon Data Systems Co.

A contract totaling $11.9 million for the construction of the Cairo Microwave System, including installation supervision and spare parts, was signed between Raytheon and the Ministry of Communication. Terms of the contract authorized payments in three increments from the effective date of the contract: 10% within 30 days, an additional 20% within 60 days, and another 20% within 90 days. Nothing in the contract specified that payments would be based on the contractor's performance. Effectively then, the contract provided for payment of 50% of the total contract cost (or almost $6 million) within the first 90 days with no linkage to performance or progress.

As requested by the USAID/E in Cairo 13022, the contract was amended to eliminate the initial 10% payment, but retained the two 20% payments as "progress payments" which totaled $4.8 million. However, all other AID and supplier documentation refer to these payments as "advances" rather than progress payments. In our opinion, lacking any reference to or requirements for contractor performance and percentage of work completion progress, both 20% payments qualify as advances and thus exceed the 10% limitation in the regulations.

Official files at the CIP offices of USAID/E included unexecuted letters of guarantee covering performance and "advance payments" to Raytheon Company. Except for the name of the contractor, Raytheon, these are unsigned samples with no amounts, dates, or other specific information yet shown. The sequence of events established in these letters support the interpretation of these payments as "advances" rather than "progress payments" since Raytheon receives the cash advances ($4.8 million) before performing under the contract. These procedures indicate weak controls over contractor performance; i.e., if these guarantee letters are not executed for any reason, or are lost, the GOE would be left with $4.8 million in advances should any foreseen event preclude the contractor from completing performance under contract terms. Agency HB 15 regulations stipulate that advances are not related to contract progress or performance. By advancing $4.8 million to the contractor, controls over performance are weakened and the GOE is put at risk of the monies advanced before contractor performance. The intent of Agency regulations pertaining to proper uses of "advances" may be circumvented and the intent of Agency regulations pertaining to effective controls over "progress payments" may also be circumvented.

While more accurate analysis of this situation and procedures could be made if actual, executed documents were in the official USAID/E files for this CIP project-like activity, the absence of these documents indicates a weakness in USAID/E ability to monitor activity progress and to control the proper use of AID funds involved. There was no apparent basis upon which the $4.8 million (20% of the contract) was determined to be commensurate with the "immediate disbursing needs" of Raytheon. We could locate no explanatory information in CIP office files.

Conclusions and Recommendations

Applicable regulations (Regulation 1, Cash Management Procedures, and HB 15) include recognition of the need for reasonable advances of funds to suppliers, in many cases, to enable performance under the contract. Suppliers benefit since advances reduce or eliminate the costs of borrowing money; theoretically, suppliers will pass such savings along to the B/Gs through lower prices. But there is no assurance of such benefits to the B/Gs and the AID-financed activities under the contract procurement processes; nor is there assurance that advances will accomplish intended purposes without effective controls. Our review showed apparent excessive advances, payments classified as "progress payments" which appeared actually to be advances, apparent inconsistencies in application of regulations and unclear/undocumented AID/W approvals. These observations and situations found are described as "apparent" because official files at the USAID/E/CIP offices did not contain complete documentation of reviews, approvals, actual contract terms or executed letters of guarantee, for examples, to show whether payments in fact met the requirements of applicable regulations cited earlier. Considering these were multi-million dollar advance payments, we could find no determinations in the files that these huge amounts were required to meet "immediate disbursing needs" (30 days) for advances; conversely, we could locate no documents supporting these payments as "progress payments" contingent upon percentage of work completion, actual costs incurred, or actual progress; in fact, available documents indicated these were effectively "advances" under HB 15 definition, and paid before completion of work reasonably related to such huge dollar amounts. Pertinent also, large payments in advance of immediate needs are costly to the U.S. Government which absorbs high interest costs to borrow funds.

In responding to the draft audit report, the USAID/E pointed out that progress payments can be an effective tool to broaden competition, encourage participation of small business, and be a positive element in the cost calculation. The USAID/E cited Procurement Handbooks for GSA as stating "....that progress payments must be directly related to accomplishment, as expressed in terms of progress <u>in the direction</u> of a single objective. A contract may provide for a progress payment on preparation, delivery, and approval of drawings and specifications; an additional payment on delivery of the finished product, and final payment upon installation and demonstration of satisfactory performance. In brief, they are a legitimate part of program financing." (USAID/E underscoring.)

While the cited GSA regulations may be suitable for direct contracting in the United States, they may not be the best guidance for Host Country contracting overseas. The special needs of B/C contracting have been recognized in AID policy and Handbook regulations, and, in the current cash management procedures. However, the cited GSA regulations require the same linkage of progress payments to costs incurred or percentage of work completion as required in our own AID Handbook covering CIP.

Neither AID regulations nor the criteria cited by the USAID/E justify these types of payments apparently related to time elapsed rather than to actual percentage of work completed or costs incurred; for example, 10% within 30 days, an additional 20% within 60 days, and another 20% within 90 days, such as the initial contractual terms given the Raytheon Data Systems Company. Another example is the multi-million dollar payment ($5.8 million or 60% of the contract total) with only a site survey to be performed.

Accordingly, we believe the following recommendations address basic problems that need Agency management attention to assure controls over these multi-million dollar payments and to better ensure program success without unnecessary costs to the U.S. Government.

<u>Recommendation No. 2</u>

AA/SER review the provisions of Handbook 15, AID Cash Management Procedures and Regulation No. 1 regarding Advances and Progress Payments to suppliers and, as necessary, clarify Handbook provisions regarding (a) the application of the 10% limit on advances within the requirements limiting advances to immediate disbursing needs (30 days), and (b) requirements for documenting reviews and decisions on the advances and progress payments that are approved.

In its response to the draft report, the USAID/E pointed out that they are currently following Agency policy. The response further states, in part, "....All requests for advance and progress payments have been submitted to the AID/W approving office (SER/COM). It is my understanding that the concurrence of the Office of Financial Management has been required and that FM/BFD has established evidence criteria required for the supplier to receive payment. All suppliers receiving advance or progress payments have been required to establish a performance bond or guaranty to secure the advance or progress payments. Government of Egypt buyers have all agreed, in writing, that any proceeds from such bonds or guarantees will be used towards completing production of the equipment or to cover the cost of new procurement.".

However, we note that the cables going to AID/W do not cite the complete basis of the progress payments. Consequently, there is a need to establish coordinated procedures within the USAID/E and in conjunction with AID/W to ensure that limitations established by the regulations and handbooks are carried into the contractual documents and clearly communicated and understood in AID/W before the authorization is granted.

Recommendation No. 3

USAID/E, in coordination with SER/COM and FM in AID/W, establish procedures and safeguards to assure proper approvals of and controls over CIP advances and progress payments to suppliers by (a) requiring reviews of proposed contract advances and progress payments for compliance with Agency's Cash Management Procedures, considering applicable Handbook 15 regulations, and (b) requiring the results of these reviews be properly documented and maintained in official files.

4. Rates of Disbursements

The rate of disbursement is an important factor in the CIP because this non-project assistance is intended to address short-term economic needs of host countries and improve their Balance of Payment positions. To achieve these program objectives of the CIP, obligated funds should be disbursed reasonably fast and have a positive impact on the economy.

The rates of disbursement under the CIP can be improved by establishing systematic procedures to identify fully completed transactions, thereby enabling USAID/E management to immediately reprogram unused balances excess to actual costs but remaining committed under issued Letters of Credit. These unused balances are "lost" in the system and unavailable for use by the GOE until they are identified and reprogrammed for other valid needs under the CIP.

Under current USAID/E practices, such unused balances are not identified on a systematic basis and may not be known to management until the loan disbursement has reached about 90 to 95% and/or completed Letters of Credit are reconciled with estimated amounts initially committed. As a result, TDD dates of loans are repeatedly extended under current practices and disproportionately high attendant administrative costs are incurred in managing the 5 to 10% remaining unused loan balances; and these remaining balances are not available to the GOE for valid disbursements.

Under a continuing-basis computer system,as we recommend,these "lost" funds could be identified early and reprogrammed for GOE use under the CIP without the need to extend TDDs. Administrative costs should be reduced substantially.

Our analysis of rates of disbursements identified unused balances totaling $954,304 in three of the loans at the 90 to 95% disbursement stage as well as the contributing causes. These three loans are about 5 to 6 years old, yet these funds totaling $954,304 are not yet actually spent, although considered, under USAID/E level procedures, as "disbursed" and unavailable for use.

Exhibit C shows the statistical correlation of rates of disbursement (measured in terms of percentage) against time (measured in terms of months). The most salient conclusions are: (a) non-durable commodities have relatively faster rates of disbursements and an earlier, more positive impact on the host country economy than other types of commodities; and (b) two areas warrant USAID/E attention. These two areas relate to (i) estimates made for Letters of Credit, and (ii) the point-in-time when the loan or grant reaches 90-95% of disbursement and unused balances may become apparent; the first area contributes towards remaining unused balances--such as $954,304 for three loans--and the two areas set in motion cyclical reactions which are adversely affecting administrative costs of the CIP.

Exhibit C and related material show:

- The time required from the date of signature to the first disbursement has ranged from 6 to 15 months. This has depended on whether the conditions precedent are fulfilled in time and on whether the processing of the financing request is initiated and approved in an expeditious manner.

- The rate of disbursement depends on the type of commodity; non-durables (tallow, corn, edible oil, tinplate, coking coal, tobacco) move much faster than durable capital equipment or project-like commodities.

- The slopes of two Loans (036 and 052) are at complete opposite extremes. Under Loan 036, imports were for spare parts, bus spare parts, tractor components, water pumps and similar durable commodities. In the case of Loan 052, imports have been tallow, corn, edible oil, tinplate, coking coal, and tobacco.

- In the case of durable or project-like commodities, rates of disbursements are not necessarily a true measure of economic impact because they include advances and progress payments to suppliers--which are substantial in amounts--for equipment that is being or will be constructed. One example is $5.8 million paid to a supplier to build equipment for the Railway Traffic Control Center; $969,000 (10%) was paid before the start of work; $4.87 million additional was paid at the point where only a document survey had been issued and no project equipment had yet been constructed.

- Three "threshold" periods are evident. The first takes place from zero to 70%; this is achieved in about 27 months, on average. The second period from 70 to 90-95%, takes nearly as much time,on average, as for the first 70% cumulative disbursement. Although the third period covers only the remaining 5 to 10%, it is the longest period and creates remnant balances (such as $954,304 discussed later in this section) which are still undisbursed. The earliest loans are about 5 to 6 years old.

Our review pinpointed the manner in which the GOE estimates Letter of Credit amounts as the primary cause of creating these small remaining balances. In this regard, the GOE normally overestimates the value of the Letter of Credit expected to be used. For example, a Letter of Credit was opened for $33.0 million of coking coal; of this $32.8 million was actually used; this created an unused balance of $0.2 million which was not known until the loan was about 95% disbursed and a reconciliation made of completed Letters of Credit with initial estimates committed. Many such differences added together total to a substantial amount. In addition, these many differences set in motion cyclical reactions within the CIP offices which add to administrative costs of the Agency.

To better illustrate, our review identified a total of $954,304 in unused loan balances. This amount represents the small remaining balances of three Loans: 026, 027, and 029. These three loans were signed about five to six years ago. They were originally supposed to have been totally disbursed within 18 months, according to statements in the Loan Paper. However, there were complications, and extensions were made. After that, the errors in estimating Letter of Credit amounts also created unknown balances. As a result, the Terminal Disbursement Dates (TDDs) of these loans were amended six times for 026, five times for 027, and two times for 029. We believe the $954,304 unused balance should have been deobligated if not needed for valid liabilities incurred prior to the TDDs. This action would be consistent with AID Handbook 19C2 (i) which requires the Geographic Bureau, through Missions, to maintain active and continuous surveillance of each loan agreement to assure that the funds obligated therein do not exceed the monetary value of the goods and/or services which AID agreed to finance.

However, we were told by the USAID/E that a new request for another TDD extension would be made.

Conclusions and Recommendations

In our opinion, a point of diminishing returns occurs when disbursements reach between 90 to 95% of all CI Program agreements in Egypt. It is at this point that previously unknown differences (unused balances) due to overestimates at the Letter of Credit stage become apparent. This in turn sets in motion cyclical reactions where differences have to be determined, small amounts accumulated and reprogrammed, purchase documents reissued, and extensions of TDDs need to be requested time after time. Trying to disburse a program from 95% to 100% becomes extremely expensive from an administrative point-of-view; administrative costs at this stage grow disproportionately since the amounts involved are much smaller. We believe that once an agreement reaches 95% of all disbursements, AID should, as general rule, allow the TDDs to expire, unless balances are true existing obligations.

Repeated TDD extensions indicate that one of the basic program objectives of reasonably fast disbursements for short-term economic impact is not being accomplished. This area, including project-like procurement under the CIP, will be discussed in detail in our forthcoming reports covering CIP internal operating procedures and the overall program review.

Recommendation No.4

USAID/E should review the remaining balances of Loans 026, 027, 029 and (a) determine if the $954,304 balance is required to meet previously incurred, and still valid, liabilities; if not so needed, (b) actions should be taken to deobligate the amount.

A forthcoming report on Internal Operating Procedures of the CIP will discuss in detail the Missions's arrival accounting system that soon will be computerized. In order to obtain more effective use of this management tool, we recommend.

Recommendation No. 5

> The USAID/E integrate into the planned arrival accounting computer program a system of retrieving exception reports that identify Letters of Credit which have been fully completed--enabling management to immediately deobligate and reprogram remaining funds on a continuing-system basis.

In responding to the draft audit report, the USAID/E agreed that the slow-down which takes place once agreements are discussed 90-95% was a valid issue. The USAID/E is aware of this problem and will be developing a plan to deal with it; this plan is to be outlined in their response to the final audit report. The response disagreed with two areas of our discussion:

- The USAID/E felt that the report identified a limited number of specific transaction issues with the implication that there was a poor overall record of disbursements. They further stated: "...While your draft Report highlights a concern that financial procedures retard timely disbursement, we are currently expending almost $1 million each day for the Program. Of the $1.54 billion obligated under the Commodity Import Program between FY's 1975 and 1979, $1.28 billion has been fully disbursed by September 30, 1980. This represents an average disbursement rate of $256 million over the period - a remarkable achievement by any standard..."

  The USAID/E felt that the judgment expressed that once an agreement reaches 95% of disbursement, that the TDD should be allowed to expire did not seem realistic. The response, in part, stated: "...Depending on the dollar amount of each Agreement, the final 5% balance may range from $4 to $22 million. The loss to Egypt of such substantial amounts simply for administrative neatness is not appropriate. Moreover, if disbursement is the main concern, deobligations, of course, is not the answer..."

The USAID/E position related to the $1.28 billion disbursement merits consideration, provided there is a clear understanding of the types of costs included in this figure. This figure includes (a) true expenditures, (b) advances and progress payments, and (c) expended funds which are not having an impact on the Egyptian economy. The true expenditures are having a beneficial impact on the economy; these items include corn, poultry, tallow, soybean, buses, trailers, and others. Advances and progress payments to suppliers, as discussed earlier in this report, do not serve a beneficial economic purpose to Egypt until the goods are delivered and are in operational status. The disbursement figure cited also includes funds disbursed and expended for items which have not begun to serve a useful economic purpose within the Egyptian economy. Two examples are: a rotary hearth calcinator ($6.7 million - December 1977 Contract); and 2,400 tractors ($17.0 million - April 1977 L/C; Contract not located). The calcinator, while it has arrived in-country, is not yet operational although almost three years have passed. The tractors were not the type ideally suitable for Egypt and were priced above ordinary farmers' means; thus demand was limited, sales were slow, and the tractors had no beneficial economic effect for extended periods of time--as late as 1980 some of these tractors were not yet sold. Total disbursements cited by the USAID/E include, for example, the $23.7 million for these two CIP transactions. Consequently, recorded total disbursements are not, in our opinion, a true measure of overall CI Program success, nor are they the truest measure of short-term economic impact of durable or project-like activities.

The CIP undoubtedly has had beneficial effects in many areas not discussed here, but this audit report section is intended to show one management area of the CIP where improvements can be made in rates of disbursements to greater benefit the Egyptian economy. USAID/E comments on broad program background and results would be better related to discussions in the forthcoming report covering overall CIP issues and conclusions.

5. Commodity Losses

Quarterly reports continue to accumulate commodity losses now totaling $3.1 million but no effective actions have been taken by the responsible action officers. USAID/E operating managers in the CIP need to identify and pursue those losses that are recoverable and collectible. USAID/E Controller records and loss reports should be adjusted and maintained to accurately reflect recoverable losses based on CIP management determinations. Procedures should be effected for continuing monitoring of losses and appropriate follow-up action.

Since the inception of the CI program, according to the USAID/Controller quarterly reports, cumulative commodity losses total $3.1 million out of $1.1 billion of commodities imported. Refunds from insurance companies cannot be obtained for those losses below the criteria of acceptable losses established by trading practices and AID/W. We were informed by USAID/E that importers do not want to initiate action to recover the losses below the acceptable criteria because it is part of the cost of doing business and is not significant enough to warrant an insurance claim. However, in instances where the losses have exceeded the criteria, action has been initiated by the GOE importers and refunds have been received from the insurance companies.

AID Regulation 1, Section 201.41 requires that the borrower/grantee maintain adequate records to document the arrival and disposition in the cooperating country of all commodities financed by AID. This responsibility was assumed by USAID/E because the Government of Egypt (GOE) did not have the capability to perform this function. To implement this function, USAID/E issued Mission Order No. (MO) 15-3 dated March 30, 1979. In part, this MO requires the USAID/E Controller to publish a quarterly report of losses. These reports are to give full details about the transactions in question. This report is to be sent for action to the Project Officer or CI manager.

In line with MO 15-3, the USAID/E Controller has been publishing a quarterly report of commodity losses but it has not been used by CIP management to initiate actions needed. Accordingly, the report continues to accumulate and show some commodity losses which will never be collected. We believe that USAID/E records should be adjusted to the amount of losses that are recoverable and continuing monitoring be done, as outlined in MO 15-3 to maintain accurate records through effective follow-up actions.

Conclusions and Recommendations

In order to adjust records to the amount of losses that are recoverable, some justifiable rationale should be submitted by operating managers to the USAID/E Controller. It should be the responsibility of operating managers to flag and pursue those losses that are recoverable and collectible. We believe the following recommendations will save time and administrative costs by limiting the reporting and action processes to only those commodity losses where managers can or need take action.

Recommendation No. 6

The USAID/E instruct CI operating managers to (a) review the quarterly report of losses; (b) determine those losses that are not recoverable; and (c) inform the USAID/Controller in writing of those losses that can be justified as nonrecoverable and noncollectible.

Recommendation No. 7

Based on information supplied by CI managers, the USAID/E Controller adjust its quarterly reports to show only those losses which are collectible and where action by responsible CI managers can be taken.

To enable continuing effective monitoring and useful accurate reporting, the USAID/E Controller should receive feedback from operating managers systematically.

Recommendation No. 8

USAID/E instruct CI operating managers, when reviewing the quarterly reports of losses for actions required under MO 15-3, to inform the USAID/Controller, on a continuing basis, of refunds collected, losses determined uncollectible, and any other actions taken that affect the status of losses shown in the quarterly reports.

6. Local Currency Counterpart Generations

AID Grant No. 263-0119, dated August 29, 1979, provided $85 million in assistance through the CIP and requires that the GOE deposit into a Special Account local currencies equal to about $70 million in proceeds accruing under the grant. Grant Implementation Letter No. 4, issued by the USAID/E on April 15, 1980, sets forth procedures with regard to establishment of this Special Account and use of the GOE "Set Aside". Deposited funds are to be used for purposes mutually agreed upon by AID and the Grantee. Planned uses of these funds can significantly benefit the United States, AID and USAID/E operations, the GOE, and the AID program in Egypt.

Although USAID/E records show activity under this grant as early as February 1980, effective controls over substantial local currency funds generated under this grant have not yet been applied by the USAID/E. Primary causes are: (a) USAID/E delayed implementing procedures regarding establishment of the Special Account and in monitoring activities therein; (b) AID/W has not furnished the USAID/E with timely or accurate Report W-214 data to enable notification to the GOE of required deposits; (c) the GOE has not furnished the USAID/E with required bank statements containing a record of deposits, withdrawals, and balances; and (d) the USAID/E did not determine activity and status of the Special Account in the absence of GOE statements.

In view of these circumstances, the audit team scheduled an examination of GOE procedures, activity, and status of the account; but this examination was delayed because access to the account was not granted for over five weeks, causing a further delay in obtaining and verifying account information.

Prior to an AID policy change in 1971 the aid-receiving country was required to deposit local currency proceeds that were generated and accrued under any form of AID commodity program assistance. These local currencies, generated from both grants and loans, were held in the name of the recipient country and made available as needed for activities mutually agreed upon between the host country and the U.S.

Since 1971 AID policy no longer requires deposits of local currency proceeds that are generated from program loans. As a result, the loan-funded programs of the CIP, the first of which were initiated during 1975, are exempt. However, under the grant-funded programs of the CIP the cooperating country still is required to deposit local currency proceeds generated from grant-funded activities. Pursuant to Congressional urging, Agency policy has been to require such deposits to be entered into an account labeled Special Account "A". Detailed AID policy concerning its foreign currency programs are highlighted in AID Handbook 19, Chapter 5.

By way of implementing the current AID policy, the USAID/E included a section on use of local currency in its CIP grant agreement number 263-0119 dated August 29, 1979. Specifically, Section 5.07 of the referenced grant contains the following requirements:

"...Grantee will establish a Special Account in the Central Bank of Egypt which account is hereinafter referred to as the 'Special Account' and deposit there in currency of the Government of the Arab Republic of Egypt in amounts equal to proceeds accruing to the Grantee or any authorized agency thereof as a result of the same or importation of the eligible items. Funds in the special account may be used for such purposes as are mutually agreed upon by AID and the Grantee at the time this Agreement is signed, provided that such portion of the funds in the Special Account as may be designated by AID shall be made available to AID to meet the requirements of the United States."

"...Deposits to the Special Account shall become due and payable quarterly upon advice from AID as to disbursements made under the Agreement. Grantee shall make such deposits at the highest rate of exchange prevailing and declared for foreign exchange currency by the competent authorities of the Arab Republic of Egypt."

The USAID/E formally set forth procedures with regard to CI Grant No. 263-0119 for the establishment of the local currency Special Account in CIP Grant Implementation Letter No. 4, dated April 15, 1980. It required:

- the GOE to establish a Special Account "A" with the National Bank of Egypt;

- the GOE to deposit local currency into the account based upon advice from AID as to disbursements made under the grant;

- the USAID/E to notify the GOE of required monthly deposits based on AID's Program Assistance Transaction Detail of Loan and Grant Activity, Report W-214. (The Report W-214 is issued from AID/W and encompasses AID's official record of monthly program disbursements of loan and grant funds.);

- deposits to be calculated at the highest rate prevailing and declared for foreign currency by the competent GOE authorities in effect on the date of each deposit; and

- the National Bank of Egypt to provide the USAID/E Controller a monthly Special Account Bank statement containing a record of deposits, withdrawals, and balances.

The sequence of events discussed below and in succeeding paragraphs highlight some of the difficulties in applying USAID/E controls over counterpart funds generated under this grant. Grant Implementation Letter No. 4 requiring the GOE to establish a Special Account "A" at a specific GOE bank and establishing formal procedures governing deposits and reporting of account activity to the USAID/E, was issued on April 15, 1980. But USAID/E records show that by Bank

Letters of Credit (L/C) for $4,963,165 and $877,460 had been issued about 2 months earlier, on February 21, and 23, 1980, respectively. Accordingly, procurement activity generating local currency deposits was underway months before control procedures over the bank account had been established or implemented. As discussed in following paragraphs, neither the GOE nor the USAID/E were complying with Special Account "A" procedures, as established and mutually agreed upon. The lack of timely and accurate information reports from AID/W contributed to this situation.

Grant Implementation Letter No. 4 requires the USAID/E to notify the GOE of required monthly deposits into the account, based on data in AID Report W-214. The GOE is also required to provide the USAID/E with monthly bank statements. But, the June 1980 Report W-214 showed no disbursements and the reports for July and August were not received so the USAID/E was unable to instruct the GOE on deposits. Although the account had substantial activity--over LE 7 million by the end of June--the GOE had not furnished statements to the USAID/E at the time of our audit. Accordingly, substantial local currency was generated with no knowledge by the USAID/E of account deposits, withdrawals and balances.

The AID accounting and information system did not work well, and information was not furnished the GOE or the USAID/E, in line with procedures established in Implementation Letter No. 4, nor did the USAID/E obtain information from the GOE.

A. The June 1980 Report W-214 received at USAID/E showed zero disbursements for the referenced grant. We were informed that the grant characters (i.e., 263-0119) caused computer rejection of disbursement information because the characters were "project" rather than "program" designations. The computer outputs for the W-214 are based on "program" designations. As a result, the grant characters were modified and given a new designation of 263-K-601. However, the W-214 for June, 1980 showed zero disbursements under the new designation as well.

B. As of mid-September 1980 the USAID/E had not yet received the July 1980 Report W-214 from AID/W.

C. As a substitute, AID/W has been furnishing monthly cables to the USAID/E containing preliminary W-214 summaries, showing cumulative grant disbursements of $15.1 million (June 30), $19.7 million (July 31), and about $28.1 million as of August 31, 1980.

D. Disbursement information for Grant No. 263-0119, contained in the available W-214, is significantly different than that shown in other reporting to the USAID from AID/W. As a result, the USAID/E Controller--lacking the official disbursement record--has not been able to notify the A.R.E. of required monthly local currency deposits into the Special Account.

As of mid-September, 1980, the GOE had not yet provided the USAID/E Controller a bank statement containing a record of account deposits, withdrawals and balances. At this point the USAID/E had no verified knowledge from the GOE of the account activity or status, nor any W-214 data to even estimate deposits to the account. As a result, USAID/E was unable to apply minimum controls anticipated in Implementation Letter No. 4.

In addition to verifying Special Account "A" activity and status, the audit team found that the GOE had unilaterally implemented deposit procedures that do not conform to Grant Implementation Letter (IL) No. 4. However, the GOE could not fully comply with Grant IL No. 4 procedures, nor could we assess them, since the Central Bank of Egypt had never received deposit instructions from the USAID/E during the period from March 6, 1980 through the time of our visit on October 28, 1980. While GOE procedures seem reasonable in view of account purposes, they indicate the need for a joint GOE-USAID/E review of current procedures in force, as previously established in Grant IL No. 4 dated April 15, 1980.

After some five weeks' delay, we were granted clearance to visit responsible GOE officials of the Ministry of Finance and the Central Bank of Egypt and given access to the account. We considered a verification of account transactions and status necessary because of the significant amounts involved, intended use of these funds, indicated problems in controls and implementing procedures and since this had not previously been done by the USAID/E.

Pertinent account information is summarized in Exhibit E and below.

A. The account is at the GOE Central Bank of Egypt, Cairo (CBE).

B. The cumulative verified balance of all transactions is LE 20,344,173 as at October 14, 1980. There were no withdrawals. We cannot reach a valid conclusion as to whether or not the cumulative deposits are equivalent to the amount required under Grant IL No. 4 procedures, since neither the CBE nor the USAID/E have accurate W-214 disbursement figures under this Grant.

C. All deposits were made at a currency exchange rate of LE.707 to US $1.

D. Grant IL No. 4 procedures have not been implemented and, to date, the USAID/E has not furnished monthly instructions/information to the CBE. The CBE has never sent monthly bank statements of the account to the USAID/E.

E. The CBE has unilaterally been crediting the account with deposits as advised by commercial L/C banks of importers. These deposits are credited on a daily basis as received; i.e., sporadically rather than every day.

The CBE has not waited for USAID/E instructions for required monthly deposits under Grant IL No. 4 procedures now in force. GOE officials informed us that, due to commercial banking procedures, the GOE procedures now followed better guarantee collections from importers than procedures established under the grant (i.e., under the grant, they must wait for USAID/E monthly instructions). Accordingly, current GOE procedures permit early deposits of generated local currencies into the Special Account with strong controls over collection of deposit funds. Under GOE procedures, single deposits, some in excess of LE 2 million, have been made on some 50 days over about a six-month period.

According to cognizant Ministry of Finance officials, basic GOE procedures are:

- The importer opens a L/C with an Egyptian "commercial" bank in the supplier's favor,

- The commercial bank requires the importer to deposit the local currency equivalent for dollar needs, and

- The commercial bank advises the Central Bank to credit the Special Account with amounts deposited by the importer.

These procedures outlined above were verified during our examination of the account at the CBE.

Conclusions and Recommendations

Substantial funds have been accumulated in this account (over LE 20 million) as of the time of audit review and about LE 50 million additional can be expected. Pursuant to Agency regulations and the Grant, planned uses of these substantial funds can significantly benefit the GOE, the AID program in Egypt, as well as AID and USAID/E operations. The GOE and AID-USAID/E have an interest in assuring proper controls over funds generated and deposited into this account until withdrawn for intended uses.

To date, Agency controls over amounts generated and deposited into the account have not been effective and implementing procedures regarding establishment and management of the account have not been followed by the GOE, USAID/E, or AID/W. To establish effective controls over the funds generated and accumulated in the account, major problems indicated need to be resolved through close coordination. We believe the basic problems include:

- The AID/W Report W-214 has not proven reliable for USAID/E use in monitoring grant disbursements.

- Procurement activity for the generation of local currencies was initiated before the GOE had set up the account for deposit of the funds generated. Two Bank Letters of Credit were issued totaling over $5.8 million during February, 1980, about two months before Grant IL No. 4 formally established the Special Account and related procedures. (The requirement for establishing the Special Account was included in the Grant dated August 29, 1979.)

- The USAID/E did not obtain required information on the account activity or status to enable effective monitoring of deposits generated.

- The GOE did not provide bank statements monthly to assist USAID/E in carrying out its monitoring responsibilities.

- The GOE unilaterally implemented deposit procedures that do not conform to Grant IL No. 4 procedures. In view of the breakdown of Grant IL No. 4 procedures, the early 1980 start of procurements under the grant, and the concern over assuring collection of all deposits generated by the grant, the procedures implemented by the COE Bank may be more effective than those established by Grant IL No. 4.

In short, Grant IL No. 4 procedures have not been effective in controlling local currencies generated because neither the GOE, AID/W, nor the USAID/E complied with these mutually agreed procedures. We believe the following recommendations address the needs of the Agency and the GOE, both having an interest in the use of these funds.

Recommendation No. 9

The USAID/E coordinate with the Central Bank of Egypt and the Undersecretary of State for Economic Cooperation and (a) determine mutually agreed upon and acceptable procedures that ensure adequate internal controls over Account No. 49-92-6031, and (b) issue the required implementing documents under Grant No. 263-0119 (263-K-601) to reflect these mutually acceptable procedures and controls.

For clarity, we believe that implementing documents under this grant should identify the Central Bank of Egypt specifically as holder of the Special Account. Grant IL No. 4 specifies the National Bank of Egypt which is also the name of a large GOE-owned bank engaged in commercial activities.

Recommendation No. 10

The USAID/E coordinate with appropriate GOE officials and enforce the requirement that the Central Bank of Egypt furnish bank statements of Account No. 49-92-6031 to USAID/E on a monthly basis.

In response to the draft audit report, the USAID/E stated, in part:

"The discussion in the draft report relates to a new procedure and negotiation is in progress. In that sense...it is inappropriately included."

Also:

"The Mission is in no position to either permit or prohibit deposits to the Special Account by the Government of Egypt. The account is in the name of the Government of Egypt and the Egyptian pounds are owned by the Government of Egypt. Since we are not in a position at this moment to reconcile such deposits with required amounts due from the Government of Egypt, the recommendations are premature. It is the intention of the Controller to restate and enforce the requirement for submission of bank statements at the time the initial billing is submitted to the Government of Egypt. I believe our discussions and negotiations with the Government of Egypt are appropriate and timely given the newness of the procedure. I believe that systems will be in final at the time of response to your final Report but again would suggest that I believe it inappropriate to include items in process as a part of normal and scheduled Mission implementation to be included in the draft."

Response to USAID/E Comments

USAID/E comments leave room for several interpretations and we address them to add perspective for the reader. From the standpoint of Agency policy and procedures, this report section does not relate to a "new procedure" as suggested in USAID/E comments. As discussed in the draft report (and on page 27 herein), AID policy, since 1971, has required the cooperating countries to deposit local currency proceeds generated under the grant-funded programs of the CIP into special accounts. Prior to 1971, these same procedures were required for local currency proceeds generated under any form of AID commodity program assistance--both grants and loans. Since additional CIP assistance is being funded under another, new grant, inclusion of this report section seems especially appropriate.

After lengthy negotiations, the bilateral "Economic, Technical and Related Assistance Agreement" between Egypt and the United States was signed on August 16, 1978. This assistance agreement included discussion on the use of grant funding in the CIP and the procedures for use of the Special Account for deposit of local currencies generated.

The application of these procedures, then, under grant funding of CIP assistance in Egypt, does not appear either "new" or "unanticipated". Considering that this grant was dated August 29, 1979 and contained provisions, in line with Agency policy, requiring the establishment of a Special Account for local currencies generated, we are not certain as to how the report discussions relate to a "new procedure" at this point in time. With first disbursements expected under February, 1980, Bank Letters of Credit issued, it does not seem unreasonable to plan and establish the Special Account at an earlier date to assure proper controls over funds generated. Little, if any, controls can be exercised over local currencies generated and collected before the Special Account has been set up to receive them.

With respect to the other USAID/E comments, we believe these recommendations address situations needing immediate management attention and should not be dismissed as premature. We believe they are warranted and useful. Given the problem areas outlined in this section, it seems in the best interests of the Agency that more effective internal controls be in-place and operationally successful. Since Grant IL No. 4 procedures now in force are not being implemented, it seems in management's best interests to assure that new controls and procedures are adequate before closure of the recommendations. If excluded from this report, as suggested by the USAID/E, there is no basis to track progress in successfully completing actions needed. The Agency and the GOE both have a substantial interest in planned uses of these $70 million in local currency generated from U.S. dollars granted.

USAID/E comments address draft Recommendation No. 8 in some detail before stating "The Mission does not agree with Recommendation No.8." This recommendation was dropped after we finally were granted access to examine Special Account "A" records and procedures.

7. Freight Costs of the CIP Programs

According to computer reports sent to us from AID/W, freight costs financed by AID under the CIP Programs in Egypt have amounted to $99,747,866. This substantial amount represents the cost of complying with the 50/50 shipping requirements of the Law. The $100 million, however, approximates 10% of total CIP disbursements (about $1 billion) at the time the computer data was extracted; this constitutes direct reduction in the inflow of commodities and use of funds within the Egyptian economy. The statistical/financial profiles show a very good analysis of the concentrations of the freight costs; those in excess of $1.0 million are shown in descending order:

Type of Commodity	Freight Costs US $ Millions
Corn Seed, Yellow Corn, Wheat Unmilled	25.2
Bituminous Coal	13.9
Tallow & Alco Oil Inedible	12.6
Power Industry Vehicles, Motor Buses, Trucks and Parts	11.7
Cotton Seed Oil	4.5
Wood Pulp	3.6
Prim Tinplate	2.6
Flue-cured Cigarette	2.4
Soybean Oil Cake & Meal	2.2
Chicken, Young, Fresh	2.0
Cotton	1.4
Tobacco	1.4
Telegraph, Telephone & Power Cable	1.3
Ocean Freight under Volag Liner & Other	1.4
Cigarette Paper & Knaft Liner	1.7
Other Commodities	11.8
TOTAL	$ 99.7

The computer reports have generated many questions regarding AID's accounting and information system for CI Programs which can only be found through further analysis of vouchers and documentation maintained in AID/W. We anticipate that a review will be undertaken by the AAG/W some time in the near future. For this reason, we are not making any recommendations.

8. Agents' Commissions

The USAID/E has made a decision, which was apparently concurred with by AID/W, to finance agents' commissions of CIP transactions as U.S. Dollar costs rather than as local currency costs. There have been questions raised during the last five years about this practice for two basic reasons: first, the practice reduces the value (estimated at $44.2 million) of actual commodity imports into the Egyptian economy; and second, the USAID/E has an inconsistent posture on this issue. In the case of capital projects, the USAID/E refuses to finance agents' commissions as an operating rule and these costs are financed with local currency; yet, the USAID/E permits U.S. Dollar cost financing under CIP.

Our examination reconfirmed the validity and basis for the questions on the practice. In fact, there is both a reduction in the value of the assistance and an inconsistency in the practice. However, the subject of agents' commissions is most complex and available information too scanty to draw firm conclusions at this point. In addition, the USAID/E, in its response to our draft report, introduced the fact that the practice extends into other areas aside from the CIProgram. For this reason, and in order to more fully consider the subject in a broader perspective, we decided to include our discussion of the issue and available facts known to us in Audit Report No. 6-263-81-3, entitled "An Overview of the Commodity Import Programs of Egypt," which will be issued o/a January 10, 1981.

EXHIBIT A

USAID/EGYPT
AUDIT OF THE FINANCIAL PROCEDURES OF THE COMMODITY IMPORT PROGRAM
IMPORTATIONS AND/OR FUNDS COMMITTED BY MINISTRIES AND LOANS AND GRANTS AS OF JULY 31, 1980

Ministry or GOE Organization	Importations In U S $000 BY LOANS (263-K-XXX)								AND GRANT	
	026	027	029	030	036	038	045	052	263-0119	TOTAL
Supply	$45,900	$30,800	$10,650	$35,000	$ 519	$219,701	$111,500	$90,000	$28,500	$572,570
Industry	25,000	6,000	25,320	33,000	6,321	79,500	88,000	90,000	5,000	358,141
Transport	1,400	600	47,030	25,341	9,175	57,750	24,157	30,000	6,500	201,953
Electricity	1,500	19,[illegible]	9,730	22,000	-	-	15,000	-	9,500	77,630
Suez Canal Authority	-	1,200	1,270	-	3,900	25,000	25,000	-	-	56,370
G.O.F.I.	-	-	-	12,000	-	24,626	5,000	-	10,000	51,826
Information	-	-	-	18,951	5,000	8,683	10,000	-	-	42,634
Agriculture	-	-	-	-	18,000	-	-	5,000	-	23,000
Local governorates	-	-	-	3,357	3,000	2,000	9,900	-	-	18,257
Housing	5,000	3,300	-	-	1,662	1,602	-	-	-	11,564
Health	-	-	6,000	-	-	3,613	-	-	-	9,613
Trade	-	7,500	-	-	-	-	843	1,000	-	9,343
Press Institutions	-	-	-	-	-	-	-	7,500	-	7,500
Education	-	-	-	159	4,140	317	-	-	17,000	21,616
Irrigation	-	700	-	192	3,204	-	-	500	-	4,596
Canal Works Company	-	-	-	-	-	2,008	-	-	-	2,008
Civil Aviation	-	-	-	-	-	-	600	-	-	600
Development and New Com	-	-	-	-	-	-	-	500	-	500
Academy of Science	1,200	-0-	-	-	-	-	-	-	-	1,200
Cairo University	-	-	-	-	79	-	-	-	-	79
Sub-Total	80,000	70,000	100,000	150,000	55,000	425,000	290,000	224,500	76,500	1,471,000
Private Sector Un-Sub-obligated	-0-	-0-	-0-	-0-	10,000	15,000	10,000	25,000 .500	8,500	68,500 .500
TOTALS	$ 80,000	$ 70,000	$100,000	$150,000	$ 65,000	$440,000	$300,000	$250,000	$ 85,000	$ 1,540,000

Note: The financial information contained in this exhibit is not exact. It represents a combination of earmarked (committed) funds, which may or may not be used; and issued Letters of Credit. In the case of issued Letters of Credit, moreover, the data includes both completed transactions and items in process; the completed transactions may not have been reduced for unused amounts; and the items in process represent a maximum amount which again may or may not be used. But the information is the best available at the current time and it represents reasonably good approximations as indicators of volume of importations to the different ministries and commodities.

EXHIBIT B

AUDIT OF THE FINANCIAL PROCEDURES AND CONTROLS OF THE CIP
STATEMENT OF DISTRIBUTION OF OBLIGATED FUNDS BY METHODS OF FINANCING
FROM FEBRUARY, 1975 (INCEPTION) THROUGH JULY 31, 1980

	In U.S. 000				In Percentages %			
Loan Number	Bank L/Com	Direct L/Com	Others	Total	Bank L/Com	Direct L/Com	Others	Total
263-K-026	$ 80,000	$ -0-	$ -0-	$ 80,000	100.0%	-0-%	-0- %	100.0%
263-K-027	70,000	-0-	-0-	70,000	100.0	-0-	-0-	100.0
263-K-029	48,000	46,000[4]	6,000[1]	100,000	48.0	46.0	6.0	100.0
263-K-030	140,774	8,226[5]	1,000[2]	150,000	93.5	5.8	0.7	100.0
263-K-036	64,058	917[6]	25[2]	65,000	98.6	1.4	-0-	100.0
263-K-038	429,343	9,019[7]	1,638[2]	440,000	97.6	2.0	0.4	100.0
263-K-045	299,400	-0-	600[1]	300,000	99.8	-0-	0.2	100.0
263-K-052	231,674	18,126[8]	200[3]	250,000	92.7	7.2	0.1	100.0
Grant 263-0119	78,500	3,000[9]	3,500[2]	85,000	92.3	3.5	4.2	100.0
Totals	$1,441,749	$ 85,288	$ 12,963	$1,540,000	93.7%	5.5%	0.8%	100.0%

Notes:

1/ PA/PR Purchase Authorization / Procurement Requisition (Medical Equipment)

2/ Adm. Res. Administrative Reservation (Excess Property-Railcars, Trailers, Hospital beds)

3/ DA Disbursement Authorization (Per Diem for training)

4/ This amount is allocated to WARD BUSES

5/ This amount is allocated to GM TRACTION MOTORS (ERS) and WARD BUSES

6/ This amount is allocated to SCIENTIFIC EQUIPMENT

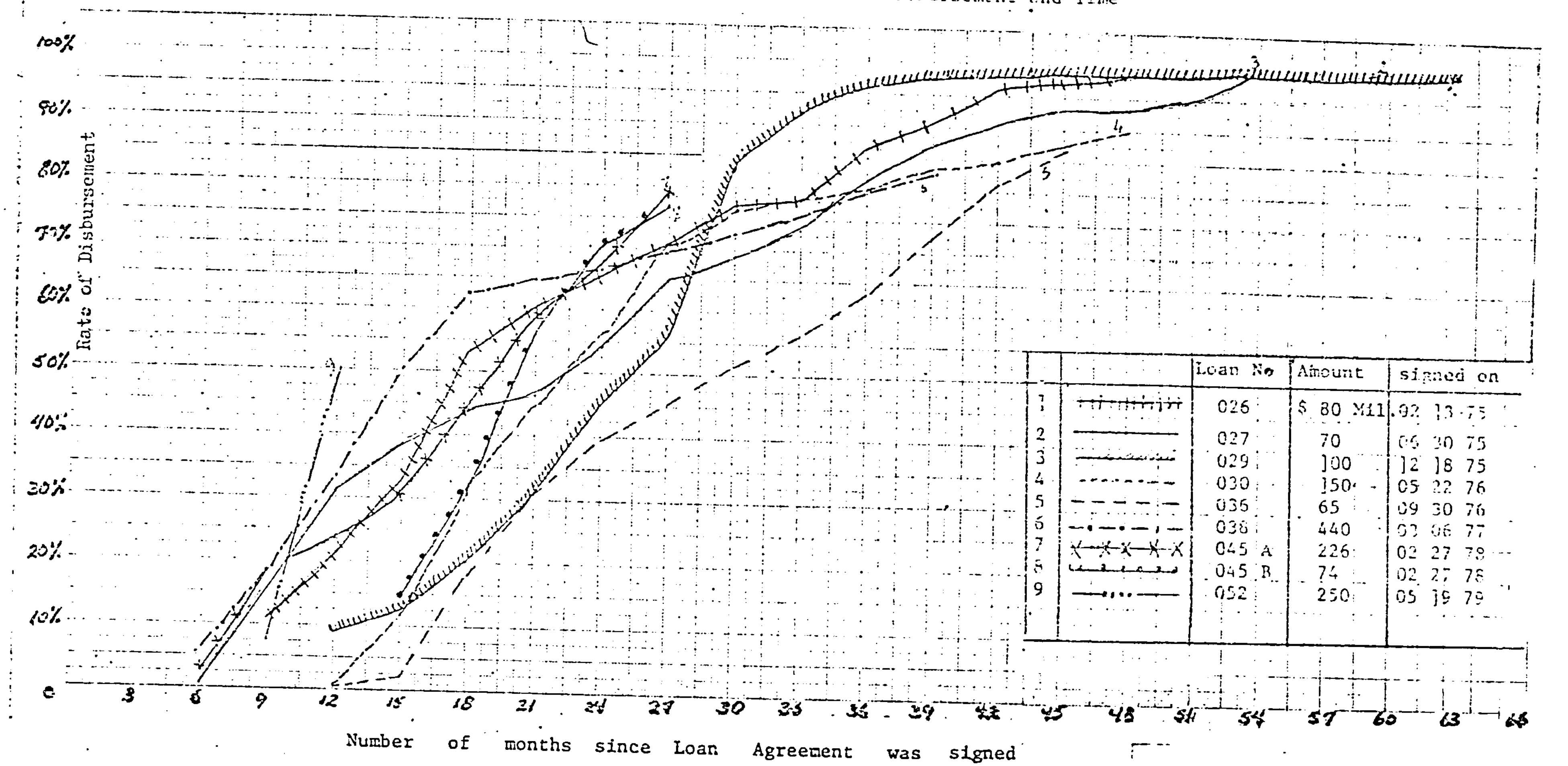
7/ This amount is allocated to REFRIGERATED RAILCARS, GM REBUILD TRACTION MOTORS and COMMUNICATIONS SYSTEMS

8/ This amount is allocated to AUTOMATIC BAKERIES

9/ This amount is allocated to BOOK PRODUCTION SYSTEM

EXHIBIT C

Audit of Commodity Import Program
Statistical Correlation of Loan Disbursement and Time



USAID/EGYPT
STATEMENT ON INTEREST AND PRINCIPAL REPAYMENT
AS OF 7/31/80

Loan Number	Interest Paid	Principal Repayment
263-K-026	$ 5,425,122	-0-
263-K-027	4,315,683	-0-
263-K-029	4,543,643	-0-
263-K-030	5,196,798	-0-
263-K-036	1,202,181	-0-
263-K-038	14,412,059	-0-
263-K-045A	3,692,936	-0-
263-K-045B	550,208	-0-
263-K-052	276,073	-0-
Total	$ 39,614,703	

Note: As of July 31, 1980, the GOE was current with its interest payments. The Grace period of 10 years have not yet expired and no billing for principal repayments have been made.

FINANCIAL PROCEDURES AND CONTROLS OF THE CIP
SUMMARY OF ACCOUNT NO. 49-92-6031--THE SPECIAL ACCOUNT
FROM APRIL 5, 1980 THROUGH OCTOBER 14, 1980

Date of Statement	Deposits Date	Deposits Amount (s) (LE) 3/	Withdrawals Amount (s) (LE)	Balance (LE)
FY 1980 1/				
April 5	Not Stated	3,603	-0-	
		21		3,624
" 16	April 5	5,919		9,544
" 17	" 16	17,736		
		41,045		
		1,844		
		7		70,177
" 20	" 17	7,308		77,486
" 22	" 20	1,796		79,282
" 27	" 22	268,806		
		330,109		678,198
May 5	" 27	14		
		4,959		683,171
" 10	May 5	1,870		685,042
" 14	" 10	7		685,049
" 15	" 14	7		685,056
" 17	" 15	25		685,081
" 20	" 17	7		685,088
" 24	" 20	266,952		952,041
" 27	" 24	7		
		32,587		984,635
" 29	" 27	4,418		989,054
June 1	" 29	20,361		1,009,415
" 2	June 1	13,683 2/		1,033,100
" 3	" 2	81,472		1,114,573
" 10	" 3	1,971,097		3,085,670
" 12	" 10	66,219		
		330,592		3,482,481
" 15	" 12	7		3,482,488
" 16	" 15	50,204		3,532,693
" 21	" 16	51,831		3,584,525
" 22	" 21	26,802		3,611,327
" 23	" 22	877,239		4,488,560
" 25	" 23	709,209		
		332,219		5,529,995
" 30	" 25	7		
		1,683,489	-0-	7,213,492

Date of Statement	Deposits Date	Deposits Amount(s) (LE) 3/	Withdrawals Amount(s) (LE)	Balance (LE)
FY 1981 1/				
July 2	June 30	258,583	-0-	7,472,075
" 3	July 2	1,963,205		
		67,802		9,503,083
" 7	" 3	7		
		7		9,503,098
" 10	" 7	1,054,822		10,557,920
" 12	" 10	337,180		10,895,101
" 13	" 12	35,327		10,930,428
" 26	" 13	217,170		11,147,599
August 2	" 26	7		11,147,606
" 7	August 2	1,625,954		12,773,560
" 9	" 7	7		12,773,567
" 13	" 9	14		
		45,471		
		76,638		12,895,691
" 14	" 13	14		12,895,705
" 20	" 14	19,089		12,914,795
" 21	" 20	26,848		12,941,644
" 23	" 21	967,014		13,908,658
" 24	" 23	143,362		14,052,020
		1,613,004		15,665,025
Sept. 3	" 24	232		15,665,257
" 4	Sept. 3	77,990		15,743,248
" 9	" 4	216,969		15,960,217
" 16	" 9	367		15,960,585
" 25	" 16	2,115,696		
		2,045,243		20,121,525
" 27	" 25	1,071		20,122,597
Updated Transactions Per Central Bank Records:				
	Oct. 2	64,279		
		124,146		20,310,995
	12	25,260		20,336,255
	14	7,918	-0-	20,344,173

Explanatory Notes:

1/ The GOE fiscal year ends June 30.

2/ Represents an LE 10,000 error on Bank Statement; i.e., Deposits Per Invoices were LE 23,683, instead of 13,683 as shown. Other minor errors due to rounding off.

3/ Includes a cumulative LE 26 shortage due to rounding off of piaster deposits.

ADDITIONAL BACKGROUND INFORMATION ON
THE COMMODITY IMPORT PROGRAMS OF USAID/EGYPT

Since 1975, when the economic assistance was initiated, there have been nine loans and one grant signed which obligate \$1.5 billion for the CIP. These funds are appropriated through the Economic Support Fund as authorized under Section 532 of the Foreign Assistance Act (FAA). The following table shows the amount of the obligated funds and their status, by loans or grant, as of July 31, 1980:

Loan/Grant No.	CIP	Amounts in US \$ Millions Obligated	Disbursed	Balance
026	I	\$ 80.0	\$ 79.9	\$ 0.1
027	II	70.0	69.9	0.1
029	III	100.0	99.2	0.8
030	IV	150.0	135.5	14.5
036	V	65.0	56.7	8.3
038	VI	440.0	372.7	67.3
045A	VII	226.0	187.2	38.8
045B	VIII	74.0	58.0	16.0
052	IX	250.0	154.2	95.8
Loans Sub-Total		1,455.0	1,213.3	241.7
Grant 0119		85.0	4.5	80.5
TOTAL		\$ 1,540.0	\$ 1,217.8	\$ 322.2

The Program Assistance Approval Document (PAAD), which is signed by the AID Administrator, presents, in capsule form, the intent of the program; this is subsequently incorporated into the loan or grant agreements.

> "The proposed loan will assist Egypt with its balance of payments deficit during the coming year. The loan proceeds will finance imports of agricultural and industrial machinery, equipment, spare parts and other essential commodities and related services. The loan will assist Egypt in its program to utilize full production capacity of existing industrial enterprises and to provide agricultural inputs essential to increase agricultural production."

The above statements have not changed significantly for the nine loans and grant, except that some loans add wording such as (a) "...and for new industrial expansion...", or (b) "...imports of food..."

The purpose of the loan or grant amounts were basically the same for the first five loans (026, 027, 029, 030, 036):

"...not to exceed...Million Dollars (the Loan) for the foreign exchange costs of commodities and commodity related services, as such services are defined by AID Regulation 1, needed to assist the Borrower to increase its industrial and agricultural production..."

The purpose of the loan or grant amounts changed somewhat for the next four agreements (038, 045A, 052 and 263-0119):

"...not to exceed...Million Dollars for the foreign exchange costs of commodities and commodity related services, as such services are defined by AID Regulation 1, needed to assist the Borrower in meeting a serious foreign exchange shortage, achieving development objectives, improving the standard of living and maintaining political stability..."

In sum, the objectives of the loans and grant are to finance types of commodities which will assist the GOE to diminish continued crisis in their Balance of Payments through maximizing production of existing or new industrial enterprises and increasing agricultural production. Importation of some food is also authorized so that political stability can continue.

About 95.5% of the obligated funds ($1.5 billion) are managed and channelled through the Public Sector of Egypt. The remaining balance, about $68.5 million, was allocated to the Private Sector.

This is the second audit report of the CIP. The series of four reviews contribute, individually or collectively, toward the following audit objectives:

To (a) evaluate the adequacy of USAID/Egypt monitoring; (b) evaluate coordination within USAID/E for the purpose of determining how CIP projects are considered in regard to the overall USAID program; (c) evaluate the progress of the CIP program toward specific objectives in industry, agriculture and the Private Sector of the economy; (d) evaluate the actual impact of the CIP program on Egypt's foreign exchange needs; (e) evaluate the extent of GOE involvement in the determination of items to be procured under the CIP program and whether the items procured are in line with the GOE economic goals; (f) evaluate the extent of coordination between the GOE ministries in the acquisition and use of the commodities imported; (g) determine the adequacy of both GOE and USAID/E arrival accounting systems; (h) evaluate whether the planned computer system will be adequate for the proper control of the CIP programs; (i) review and evaluate controls over counterpart generations; and (j) determine the extent of action taken on prior recommendations.

LIST OF REPORT RECOMMENDATIONS

	Page
Recommendation No.1 USAID/E establish procedures to (a) carry out Agency policy set forth in State Telegram 273219; (b) review and evaluate each procurement transaction to determine the most effective financing method; and (c) document and record the results of each review.	13
Recommendation No.2 AA/SER review the provisions of Handbook 15, AID Cash Management Procedures and Regulation No.1 regarding Advances and Progress Payments to suppliers and, as necessary, clarify Handbook provisions regarding (a) the application of the 10% limit on advances within the requirements limiting advances to immediate disbursing needs (30 days), and (b) requirements for documenting reviews and decisions on the advances and progress payments that are approved.	19
Recommendation No.3 USAID/E, in coordination with SER/COM and FM in AID/W, establish procedures and safeguards to assure proper approvals of and controls over CIP advances and progress payments to suppliers by (a) requiring review of proposed contract advances and progress payments for compliance with Agency's Cash Management Procedures, considering applicable Handbook 15 regulations, and (b) requiring the results of these reviews be properly documented and maintained in official files.	20
Recommendation No.4 USAID/E should review the remaining balances of Loans 026, 027, 029 and (a) determine if the $954,304 balance is required to meet previously incurred, and still valid liabilities; if not so needed, (b) actions should be taken to deobligate the amount.	23
Recommendation No.5 The USAID/E integrate into the planned arrival accounting computer program a system of retrieving exception reports that identify Letters of Credit which have been fully completed--enabling management to immediately deobligate and reprogram remaining funds on a continuing-system basis.	24

A C R O N Y M S

AA/SER	AID Assistant Administrator/Bureau for Program and Management Services
AAG/E	Area Auditor General/Egypt
AAG/W	Area Auditor General/Washington
AG	AID Auditor General
Agency	Agency for International Development
AID	Agency for International Development
AID/W	Agency for International Development/Washington
A.R.E.	Arab Republic of Egypt
B/G	Borrower Grantee (contracts between host governments and suppliers)
Bank L/Com	Bank Letter of Commitment
CIP	Commodity Import Program
Direct L/Com	Direct Letter of Commitment
DM	AID Office of Data Management under the Bureau for Program and Management Services
ESF	Economic Support Fund
FAA	Foreign Assistance Act
FM	AID Office of Financial Management
GASC	Government of Egypt - General Authority for Supply Commodities (Ministry of Supply)
GC	AID Office of the General Counsel
GOE	Government of Egypt
HB	The AID Handbook
L/C	Letter of Credit
Mission	See USAID/E
MO	Mission Order
RTC	Railway Traffic Control (System)
SCA	Suez Canal Authority
SER/COM	The Office of Commodity Management in AID/W
TDD	Terminal Disbursement Date
TFRM	U.S. Treasury Fiscal Requirements Manual
USAID/E	U.S. Agency for International Development/Egypt

LIST OF REPORT RECIPIENTS

USAID/EGYPT	
Director	7
Controller--Audit Liaison Officer	2
Inspections and Investigations Staff (AG/IIS/Cairo)	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 (Audit Liaison Officer)	1
Assistant Administrator/Bureau for Program and Management Services (AA/SER)	2
Bureau for Program and Management Services (AA/SER/SA--for distribution to SER/CM, SER/COM and COM/NE)	4
Assistant Administrator/Bureau for Development Support	1
Office of Development Information and Utilization (DS/DIU)	4
Office of Legislative Affairs (LEG)	1
Office of the General Counsel (GC)	1
Office of Financial Management (FM)	1
Bureau for Program and Policy Coordination/Office of Evaluation (PPC/E)	1
Legislative and Public Affairs Office of IDCA	1
Office of the Auditor General (AG)	1
Office of Policy, Plans and Programs (AG/PPP)	1
Office of the Auditor General/Executive Management Staff (AG/EMS/C&R)	12
Office of Inspections and Investigations (AG/IIS)	1
Area Auditor General/Washington	1
Area Auditors General	
Area Auditor General/East Africa	1
Area Auditor General/East Asia	1
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Area Auditor General/Near East--New Delhi	1
Area Auditor General/Latin America	1
Area Auditor General/Latin America--La Paz	1