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AUDIT OF
NEIGHBORHOOD URBAN SERVICES
USAID/EGYPT ACTIVITY NO. 263-0161.05
Audit Report No. 6-263-86-4
March 26, 1986

UNITED STATES GOVERNMENT
memorandum

DATE:

March 26, 1986

REPLY TO
ATTN OF:

Joseph R. Ferri
Joseph R. Ferri, RIG/A/Cairo

SUBJECT:

Audit Of Neighborhood Urban Services
USAID/Egypt Activity No. 263-0161.05

TO:

Mr. Frank B. Kimball, Director USAID/Egypt

This report presents the results of an audit of the Neighborhood Urban Services Activity No. 263-0161.05. The audit showed that the Activity was well managed and was in compliance with governing requirements. Internal controls were generally adequate.

Funds made available for district and governorate programs, however, were not used as quickly as contemplated resulting in about \$14 million in unspent funds being kept in non-interest bearing accounts at local banks. In addition, USAID/Egypt was not tracking the expected Government of Egypt contribution of \$11.7 million to the Activity. We recommended that further funding be limited where progress was slow and obtaining assurances that agreed upon contributions by the Government of Egypt have been provided.

The comments you provided on the draft report indicated the report was useful. Moreover, implementing the recommendations would improve the project and establish several useful procedures for implementing the follow on project. As a result of the actions taken, we were able to close one of the three recommendations upon issuance of the report. Your comments, without the attachments, are included as Appendix 1 to the report.

Please provide us within 30 days of actions taken to clear the remaining recommendations in this report.

Background

The Government of Egypt (GOE) and USAID/Egypt signed an agreement in August 1981 to implement the Neighborhood Urban Services Activity (NUS) project. The purpose of the project is to enhance the institutional capability of local

governments to carry out modest-sized public services projects for the urban poor. These projects are greatly diversified and include such things as recreation centers, dental clinics, day-care activities, and water and sewer connections. A limit is imposed, so that most projects cannot exceed \$100,000. A total of over 2,000 projects were initiated through fiscal year 1985. The Project Assistance Completion Date is September 30, 1986.

USAID/Egypt agreed to contribute up to \$89 million in grant funds, while the GOE agreed to contribute the equivalent of \$13.9 million in Egyptian pounds. Total GOE contributions under the latest Agreement, May 14, 1984, were set at the equivalent of \$11.7 million 1/.

AID's contribution includes funds for technical assistance. This assistance is being provided under a direct contract signed May 6, 1982, with Wilbur Smith and Associates. Through August 31, 1985, USAID/Egypt had committed \$7.8 million to fund this contract, which is due to expire June 30, 1986.

As of August 31, 1985, USAID/Egypt had committed \$75 million of the \$89 million obligated, and disbursed \$72 million.

Audit Objectives And Scope

The objectives of this economy and efficiency audit were to determine if: (a) activity resources were efficiently and economically managed by the Government of Egypt and the technical services contractor; (b) activities were in compliance with AID regulations, policies, and activity documents; and (c) internal controls for AID-provided funds were satisfactory.

We reviewed records, reports and document files at USAID/Egypt and at the consultant's office in Cairo. GOE documents and records in Cairo and in the governorates of Cairo, Alexandria, Giza, and Qaluibia were examined and discussions were held with Egyptian officials involved in the NUS activity at these locations. Selected subprojects were visited in the four governorates receiving USAID/Egypt grant funds (Cairo, Alexandria, Giza and Qaluibia). The

1/ Egyptian pounds were converted at the rate of .83168 to the U.S. dollar.

audit of the consultant's contract consisted of site visits to in-country projects being carried in the governorates and a test of controls over Egyptian pound costs.

The audit covered controls over all of the \$72 million disbursed by USAID/Egypt through August 31, 1985. Because there was an adequate management system in place, audit work was limited to selected tests of financial transactions. A detailed audit of the project was not made.

Audit work began in September 1985; field work was completed the following month. There were no prior Office of Inspector General audits of the NUS activity. An external evaluation of the project was completed in January 1985.

Results Of Audit

The audit results showed that this activity was generally well managed, and in compliance with AID regulations, policies and activity documents. Internal controls were satisfactory except for weaknesses in ensuring timely use of funds made available for district subprojects and special program purposes.

The consultant contractor had a reliable computerized tracking system for the approximately 2000 subprojects financed by USAID/Egypt. With the direct assistance of the contractor the NUS activity was meeting its targets, both in the number of subprojects implemented and in the number of Egyptians trained. According to project officials, over 9 million Egyptian beneficiaries in 23 urban districts within four governorates have been reached.

Positive results notwithstanding, implementation problems existed. Funds for numerous district subprojects and a special governorate maintenance garage program were unused for over a year. Also, there was no systematic tracking of GOE contributions. We recommended that funding be restricted where the lack of progress warranted such action, and that reports be obtained from the GOE for its contributions.

1. Unspent Funds Result in Unnecessary Interest Costs

Funds disbursed by USAID/Egypt to the GOE were not used for district subproject and governorate maintenance garage purposes during the intended timeframe. USAID/Egypt's disbursements were based on the assumption that subprojects would be completed, and the funds used, within one year. As

a result of construction delays, about \$14 million was tied up for over a year in non-interest bearing accounts in local banks. At a 9 percent interest cost to the U.S. Government, these unspent funds cost the U.S. Government about \$1.3 million per year.

District Subprojects

Under district subproject activities, USAID/Egypt disbursed funds annually to the GOE. These disbursements were based on submissions by the GOE of projects to be undertaken at the district level of the various governorates. The GOE allocated the monies received down to the governorate level, and then to the district level. USAID/Egypt provided the funds under authorization of Project Implementation Letters issued by USAID/Egypt's Office of Local Administration and Development upon requests by the GOE. In the districts, the funds were deposited in non-interest bearing accounts and withdrawn when the approved subproject activity took place. The operative assumption for USAID/Egypt's disbursing the funds was that the subprojects would be completed within one year.

The established criteria of implementing and completing subprojects within one year was followed to a large extent. About 627 out of 768, or 82 percent, of the total subprojects tracked by the consulting contractor were completed as of August 31, 1985. In the governorates of Cairo, Giza, and Qaluibia, however, most of the projects financed by USAID/Egypt fiscal year 1984 funds were not complete. Out of 150 fiscal year 1984 projects, only 27 were reported to be complete by August 31, 1985, more than one year after the funds were first made available.

Selected districts within the governorates of Cairo and Giza were examined to see what happened to the funds provided for their projects. In Helwan and Eastern districts of Cairo, we found all fifteen projects were not completed. Of the \$943,872 made available, only \$30,834 had been spent. In Helwan, for example, out of the \$384,763 that were made available, only \$1,020 had been spent.

At the time of our visit to the Qaluibia governorate in October 1985, none of the seven approved subprojects for the West district had been completed. Of the \$453,900 made available for these subprojects, only \$299,647 had been spent. Two of the projects had received allocations totaling \$54,107 but were postponed because the allocations were insufficient to implement the projects.

In fiscal year 1984, USAID/Egypt provided about \$9.19 million to the GOE for district subprojects. More than a year later, on August 31, 1985, about \$5.65 million were still unspent. Despite the slow progress in completing subprojects, USAID/Egypt disbursed an additional \$5.3 million for fiscal year 1985 subprojects. The reason for the buildups in unused funds was that USAID/Egypt disbursed funds to the GOE on the basis that approved subprojects would be completed within one year of the disbursement. The funds were not spent during the period for a variety of reasons. Although the status of the projects and amount of available funds were readily reported by the consulting contractor, USAID/Egypt project officials approved the release of additional funds.

Unused funds represent an interest cost to the U.S. Government. In this case, at 9 percent, the imputed interest cost on \$5.65 million unspent funds in district subprojects was about \$508 thousand per year.

Recommendation No. 1

We recommend that USAID/Egypt withhold additional funding under Implementation Letters for Government of Egypt district subprojects where progress in completing activities is significantly behind schedule.

Management Comments

USAID/Egypt acknowledged the seriousness of the matter. It said that the Project Officer had since met with each Governor and District Chief involved in the project and told them of the concern for timely use of the money. Good progress must be made on all past projects before any further annual disbursements will be made for district subprojects. Criteria governing further funding availability for district subprojects was developed and was expected to be applied through issuance of a Project Implementation Letter.

Office Of Inspector General Comments

The USAID/Egypt action should result in better control over the use of funds at the district level. Issuance of the Project Implementation Letter should serve to close this recommendation.

Construction of Maintenance Garages

Excessive USAID/Egypt funds were also tied up in a program to construct maintenance garages in four governorates. A total of \$8.57 million was disbursed to the four governorates in 1984, but only \$42,819 was spent through August 31, 1985. Thus, the equivalent of \$8.53 million remained unspent more than a year later. The imputed interest cost, at 9 percent, would be about \$768 thousand per year.

In Alexandria, construction of garage facilities was not yet underway for a variety of reasons. GOE action was needed to: obtain a land title; prepare sites; issue an IFB; prepare a bill of materials; and provide their share of funds. Although USAID/Egypt funds of \$2,561,000 for this program were deposited in the governorate's bank account on May 30, 1984, only \$24,047 had been disbursed. Similar conditions with respect to disbursements existed in the other governorates. According to GOE governorate officials, two additional years will be needed to complete the facilities at Alexandria, provided that additional AID funds are received.

Recommendation No. 2

We recommend that USAID/Egypt make no additional funds available for maintenance garages until the Government of Egypt has resolved construction delays.

Management Comments

USAID/Egypt said that the Project Officer had discussed the problem with the appropriate Egyptian Governors. The situation on the pace of construction was improving and each governorate had been asked to prepare a new implementation plan for each garage site along with an analysis of cash requirements for the next two years. An Implementation Letter will be prepared requesting that funds not required during the next six months be returned to USAID/Egypt. The funds will be decommitted but remain earmarked for the garage program and be ready for disbursement as actual site work progresses. Delaying the disbursement of funds to coincide with construction progress should result in significant savings of interest costs to the United States Treasury. Completion of the proposed actions should suffice to close the recommendation.

Office Of Inspector General Comments

Completion of the proposed actions will close this recommendation.

2. Government of Egypt Contributions Were Not Tracked

The GOE provided funding to the project. USAID/Egypt, however, did not know the actual level of support provided because the information was not required to be reported. Without this information, USAID/Egypt could not ensure that the GOE's contributions met required support levels.

The GOE made observable contributions, such as maintenance funds and incentive payments, and thereby demonstrated project support. The extent of its total contributions, however, had not been reported to USAID/Egypt because no requirement existed to do so. In Alexandria, for example, the governorate received allocations totaling \$2,255,675 from the GOE's Ministry of Finance, but these were not reported to USAID/Egypt.

Thus, USAID/Egypt project officials were not monitoring this activity as required and ensuring that the GOE had met its full obligations under the Activity Protocol to provide project financial support. Annex I of the Activity Protocol specifies Grantee contributions for incentive payments, maintenance funds, and indirect sub-activity costs that total about \$11.7 million.

USAID/Egypt needs to assure that the GOE has provided the agreed upon contributions to the project. In particular, USAID/Egypt should be assured that the GOE is providing adequate maintenance support for subprojects through its contributions. The support may not be adequate. A January 1985 Evaluation Report by the International Science and Technology Institute stated that "To date the GOE has been slow to release these funds (maintenance) and relatively uninterested in taking up the responsibility for maintenance."

Recommendation No. 3

USAID/Egypt should fulfill its monitorship responsibilities by assuring that the Government of Egypt has provided the agreed upon contributions to the project.

Management Comments

USAID/Egypt provided evidence of contributions by the GOE to the NUS project. More important, a system for accounting for GOE contributions has been set up for future local development projects. USAID/Egypt will receive quarterly reports from the Ministry of Finance on contributions for incentives and operation and maintenance; and will establish a tracking system which will report GOE contributions and expenditures to both the Ministry of Finance and USAID/Egypt.

Office Of Inspector General Comments

The actions taken by USAID/Egypt satisfy the intent of the recommendation. Therefore the recommendation is closed upon issuance of this report.

3. Other Pertinent Matters

a. Liquidation of Emergency Fund Advances

Emergency Fund criteria requires that when approximately half of the funds advanced have been used, documentation will be submitted to the USAID/Egypt Project Officer to liquidate the advance. The consultant's progress report, as of August 31, 1985, showed that the GOE had expended \$808,000 (about 67%) of \$1,202,386 advanced. USAID/Egypt had not received documentation from the GOE to liquidate the advances, thereby understating project expenditures by about \$808,000. USAID/Egypt should systematically obtain the required documentation from the GOE to liquidate Emergency Fund advances.

Management Comments

"\$750,000 of \$1.2 million has been liquidated. Qalubia and Alexandria have agreed to return their balances to be reallocated to district subprojects. Cairo is proposing to buy US equipment for emergency purposes if it can be found on the local market -- otherwise we will ask them to refund the money and reprogram it."

b. Office Equipment Fund

The Cairo governorate purchased office equipment (184 typewriters costing \$64,946) that was produced in a non-eligible country (East Germany). AID Handbook 1 (Sup B) prohibits procurement of imported off-the-shelf items from a non-free-world country.

On May 30, 1985, the GOE was informed that the purchase was not eligible for AID financing, and that the equipment fund should be reimbursed for the full amount. Moreover, the GOE did not have a special bank account for the fund as required by authorizing PIL No. 16; instead, the office equipment funds were mixed with funds in another NUS account.

USAID/Egypt should ask the GOE to transfer unused office equipment funds, including the reimbursable amount due, to a special bank account as provided by PIL No. 16.

Management Comments

"Cairo has refunded the money and it purchased equipment of appropriate source and origin."

c. Vehicles

The seven vehicles that the consulting contractor purchased in 1982 with AID-financed contract funds were not properly licensed. The titles of ownership were in the name of Wilbur Smith and Associates, contrary to the contract (Additional General Provision 5), which states that the contractor will have custody of AID-financed property but title will be in the name of the Cooperating Government.

USAID/Egypt should require that the contractor-purchased vehicles be licensed in the name of the GOE.

Management Comments

We have written to the contractor asking them to prepare for the transfer of the vehicles to the GOE at the end of their contract in June 1985."

d. Cash Management

At the project level, reconciliations were not made of USAID/Egypt disbursements to the GOE (as shown on USAID/Financial Management records), and funds placed in GOE bank accounts.

Although no exceptions were found when we traced USAID/Egypt disbursements through Wilbur Smith's reporting system to various governorates and district bank accounts, periodic reconciliations are needed to ensure that all USAID/Egypt disbursements to the GOE are deposited in GOE bank accounts for project purposes. This verification process is needed for proper internal control.

USAID/Egypt should strengthen project internal controls through a verification process that reconciles funds disbursed by USAID/Egypt with funds deposited in GOE bank accounts.

Management Comments

"In all future disbursements we will ask the GOE for bank deposit records which show the final destination of all project funds, and ensure that funds are deposited in the appropriate accounts at all levels of local government. The Implementation Letter sent with each disbursement will request that the appropriate records be supplied after receipt of each disbursement."

Office Of Inspector General Comments

The actions taken by USAID/Egypt on each item in this Other Pertinent Matters section are responsive to the observations made during the audit. Further action on these matters is unnecessary.



CAIRO, EGYPT

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

March 19, 1986

MEMORANDUM

TO: Mr. Joseph Ferri, RIG/A/Cairo

FROM: Arthur Handly, A/DIR *Arthur Handly*

SUBJECT: Response to Draft Audit Report on
Neighborhood Urban Services; Project No. 263-0161.05

Attached is the subject response prepared by the project officer. We request these comments be included in the final report and that recommendation number 3 be closed upon issuance of the report.



UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

March 17, 1986

CAIRO, EGYPT

MEMORANDUM FOR RIG/A/CAIRO, WILLIAM SPAT (ACTING)

FROM : Acting Director Arthur Handly *Handly*

SUBJECT: Draft Audit Report : NUS (263-0161.05): Mission Response

We feel that this is a useful report. Implementing the recommendations will improve the project and also establish several useful precedents for the implementation of LD II.

Comments and actions taken to date:

Recommendation 1: District Subprojects

On page 7 it is stated that \$5.6 million for district subprojects has been tied up ("unspent") for over a year in non-interest bearing accounts. On Aug. 31, 1985, the date of the audit, \$ 4.24 million of the \$5.6 million had been committed to contracts for subprojects -- so the money was in use. As of today over 70% of the funds have been expended by the districts.

We recognize that this was a serious problem. Since January 27, 1986 the NUS Project Officer has met with each Governor and District Chief involved in the project and told them of our concern for timely use of the money and that good progress must be made on all past projects before any further annual disbursements will be made for district sub-projects. We propose to write an Implementation Letter reinforcing the following criteria:

" Prior to any request for additional funds being made by a district the following should be accomplished by the district:

1. All past projects must be started;
2. The following expenditure rates must be reached for all funds previously disbursed to the districts:
 - for 1981/82 funds : 100%
 - for 1983/84 funds : 85%
 - for 1984/85 funds : 50%

The expenditure rate criteria (percentages) will roll forward each year as additional annual disbursements are made."

We will forward a copy of the Implementation Letter to you. I understand that this action will enable you to close the recommendation.

Recommendation 2: Maintenance garage construction.

During the same visits mentioned above, the Project Officer discussed this problem, at length, with the appropriate governors.

He found construction underway in Qalubia, with a six month completion date realistic. In the other three Governorates we found the situation less advanced -- though Giza has bidding underway, and Alexandria has started to prepare sites, using its own funds.

We have asked each governorate to prepare a new implementation plan for each garage site, and an analysis of cash requirements over the next two years. We will then request, in an Implementation Letter, that funds not required during the next six months should be returned to AID. These funds would then be decommitted, but remain earmarked for this garage program and be ready to be disbursed quarterly as each site progresses. This action may result in significant savings of interest costs to the US Treasury.

We understand that these actions will enable you to close this recommendation.

Recommendation 3: GOE contributions

This Mission has not, in the past, tracked GOE contributions closely.

With regard to NUS we have records of contribution of the NUS maintenance funds (attachment 1), and we know that training funds were disbursed, and some incentives payments were, and continue to be, made.

This problem has clearly been addressed in the design and the implementation of LD II, during the past year. The system for accounting for GOE contributions has been outlined by the MOF in a letter (attachment 2) which satisfied a CP to disbursement in LD II.

During the first year of LD II (1986) we will require the GOE to account for the 10% and 20% maintenance funds established during DSS I in BVS, NUS, and DSF. Accounting for these funds will be a required part of planning the first year's operation and maintenance program in LD II, and will be completed before any LD II investment funds from USAID are disbursed.

Auditor's Note:

The attachments referred to above and on Page 4 of this Appendix are not included in this report.

During the implementation of LD II USAID will receive a quarterly accounting from the MOF of all BAB I and II contributions for incentives and operation and maintenance. MPIC and Governorate contributions to investment and MOF contributions to operation and maintenance are CPS to our disbursements. We will establish a tracking system which will report GOE contributions and expenditures to both MOF and USAID.

We suggest that these forward looking design and implementation steps will solve the problem and that we not engage in a retrospective accounting of past contributions. Based upon these actions we request that the recommendation be closed.

Other Matters:

Emergency Funds: \$ 750,000 of \$ 1.2 million has been liquidated. Qalubia and Alexandria have agreed to return their balances to be reallocated to district subprojects. Cairo is proposing to buy US equipment for emergency purposes if it can be found on the local market -- otherwise we will ask them to refund the money and reprogram it.

Office Equipment Fund: Cairo has refunded the money and it purchased equipment of appropriate source and origin, as shown in the attached report (attachment 3).

Vehicles: We have written to the contractor asking them to prepare for the transfer of the vehicles to the GOE at the end of their contract in June, 1985. A draft copy of this letter is attached.

Cash Management: In all future disbursements we will ask the GOE for bank deposit records which show the final destination of all project funds, and ensure that funds are deposited in the appropriate accounts at all levels of local government. The Implementation Letter sent with each disbursement will request that the appropriate records be supplied after receipt of each disbursement.

APPENDIX 2

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