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AUDIT OF
USAID/EGYPT CONTROLS OVER THE
SPECIAL ACCOUNT
Audit Report No. 6-263-87-9
June 25, 1987

UNITED STATES GOVERNMENT

memorandum

DATE: June 25, 1987

REPLY TO ATTN OF: Joseph R. Ferri, RIG/A/Cairo

Joseph R. Ferri

SUBJECT: Audit Of USAID/Egypt Controls Over The Special Account

TO: Mr. Arthur M. Handly, Director USAID/Egypt (A)

This report presents the results of the audit of USAID/Egypt Controls Over The Special Account. The objectives of this financial and compliance audit were to assess the adequacy of controls over the funds collected and deposited into the Special Account and of USAID/Egypt's programming and use of account funds.

The United States, between 1979 and 1986, provided Egypt with more than $1.7 billion in grant funds under the Commodity Import Program and the Production Credit Project. Local currency generated from these activities was to be used for mutually agreed upon purposes. In accordance with the requirements of Section 609 of the Foreign Assistance Act of 1961, as amended, and the Bilateral Assistance Agreement of 1978, the Government of Egypt in 1980 established a Special Account in its Central Bank. As of December 1986, there were a reported 439 million Egyptian pounds (about $325 million) in the account.

The Special Account was critically reviewed by the Office of the Inspector General in 1980 and by the General Accounting Office in 1984. Partly in response to those audit reports, USAID/Egypt made a concerted effort between 1984 and 1986 to improve the processes for verifying and reconciling collections and deposits. These problems were not fully resolved, however, because the Government of Egypt failed to implement agreed upon accounting controls for collections and deposits.

The audit showed that certain amounts were not being appropriately recorded and reconciled. Special Account funds were ineffectively programmed and used, and withdrawals were not traceable to specific end uses. The use of "setasides" diminished the amount of required deposits. Finally, Special

Account funds were held at the Central Bank of Egypt in a noninterest-bearing account, thereby lessening the amount of local currency that otherwise could have been available for further development activities.

We recommended that USAID/Egypt require deposits of proceeds based on AID disbursement records. USAID/Egypt should advance plan its fiscal year project support requirements, pursue new development areas, transfer funds directly to project accounts, and establish definitive ground rules for setasides. It should also consider placing Special Account funds into interest-bearing accounts.

USAID/Egypt management did not agree with all these recommendations but was undertaking new initiatives with the Government of Egypt for more efficient use of Special Account funds. The USAID/Egypt comments on the draft report as well as the Office of the Inspector General comments are included at the end of each finding section. The full text of USAID/Egypt's comments is included in the report as Appendix 1. Please advise us within 30 days of any actions taken or contemplated in order to close the recommendations.

EXECUTIVE SUMMARY

Between 1979 and 1986 the United States provided Egypt with more than $1.7 billion in grant funds under the Commodity Import Program and the Production Credit Project. Local currency generated from these activities was to be used for mutually agreed upon purposes. Section 609 of the Foreign Assistance Act of 1961, as amended and the Bilateral Assistance Agreement of 1978 between the United States and the Government of Egypt (GOE) required that:

> ...in cases, where commodities or services are furnished on a grant basis under arrangements which will result in the accrual of proceeds to the GOE from the import or sale of such commodities or services, the GOE will establish a special account and will promptly deposit the amount of local currency equivalent.

In accordance with these requirements, the Government of Egypt established a Special Account in its Central Bank for the local currency deposits. As of December 1986 there were a reported 439 million Egyptian pounds (about $325 million at the LE1.35 rate) in the account.

The objectives of this financial and compliance audit were to assess the adequacy of controls over: (1) the accountability and reconciliation of funds collected and deposited into the Special Account; and (2) USAID/Egypt programming and utilization of account funds.

The audit showed that local currency collections and deposits into the Special Account were not adequately recorded and reconciled. Local currency available in the account was not effectively programmed and used. Commodity Import Program "setasides" exempted certain importers from deposit requirements without sufficient justification. Special Account funds were retained on a noninterest-bearing basis at the Central Bank.

USAID/Egypt made a concerted effort between 1984 and 1986 to improve the processes for verifying and reconciling collections and deposits. Its efforts enabled the Mission to gain some assurance that controls over the account were being exercised. Nevertheless, the Mission could not fully resolve the problems noted in prior audits mainly because the Government of Egypt did not implement the agreed upon accounting system for collections and deposits.

In view of the Government of Egypt's failure to fulfill its responsibilities, USAID/Egypt regularly attempted to independently verify collection and deposit information with local banks. This time-consuming process enabled the Mission to calculate approximate balances in the account and to disclose the existence of arrearages by Egyptian importers. Without GOE implementation of the agreed-upon accounting procedures, however, USAID/Egypt could not verify all disbursements to U.S. exporters, and all repayments by Egyptian importers. As a result, deposits into the Special Account could not be appropriately verified and reconciled. We recommended that if the Government of Egypt did not implement the agreed-upon procedures in a timely and effective manner, that USAID/Egypt require immediate deposit of all required proceeds by the Government of Egypt, based on official reports of AID Commodity Import Program disbursements. The Mission replied that other ways to solve the problem would be explored, but was unwilling to impose requirements for deposit that were considered unrealistic and could impede dollar disbursements.

Special Account funds, totaling about 439 million Egyptian pounds, (about $325 million at the LE1.35 exchange rate), as of December 1986, were not effectively programmed and used to support USAID/Egypt projects and other development activities. AID Policy Determination No. 5 encourages Mission participation in programming local currency generated by the sale of commodities when such involvement promises to help in achieving developmental objectives. USAID/Egypt was not involved early enough in the programming process to materially influence how Special Account funds could be effectively used for development objectives. Protracted negotiations with the Government of Egypt shifted the focus from advance planning to meet USAID/Egypt project requirements to reimbursing the Ministry of Finance for funds already spent. Moreover, most Special Account funds withdrawn for mutually agreed upon project uses were commingled with other Government of Egypt resources. USAID/Egypt, therefore, lacked appropriate safeguards to ensure that projects actually received those funds. As a result of the ineffective programming of funds, USAID/Egypt did not take advantage of the opportunity to expand development activity in Egypt with Special Account funds. We recommended that USAID/Egypt maximize the use of Special Account funds, pursue new development areas with the Government of Egypt and establish a system for transferring funds directly to projects. The Mission commented that initiatives were being taken to improve Special Account programming and use, but that the need for detailed tracking of Special Account funds to projects was not a necessity.

Commodity Import Program "setasides" totaling $117 million, exempted certain importers from depositing local currency into the Special Account. Mainly, these importers were not revenue-generating activities and, therefore, not subject to deposit requirements. These setasides, however, were made without clear USAID/Egypt ground rules and legal justification for exempting such transactions from the deposit requirements. Section 531(d) of the Foreign Assistance Act of 1961, as amended, requires that commodity import local currency generations be maximized. As a result, potential deposits to the Special Account may have been inappropriately excluded. We recommended that USAID/Egypt establish definitive ground rules for setasides that comply with Section 531(d) of the Foreign Assistance Act of 1961, as amended. The Mission replied that flexibility was needed in requiring generations of local currency and that a special Mission Order was not necessary.

Local currency proceeds were deposited into a noninterest-bearing Special Account at the Central Bank of Egypt. AID policy suggests that Missions consider the deposit of such proceeds into interest-bearing accounts at commercial banks to help finance development activities, but USAID/Egypt did not pursue such a policy for some unexplained reason. If the Special Account balance on deposit in December 1985 had accrued interest at 9 percent for one year, additional funds totaling about $19.5 million could have been generated for developmental uses. Over the life of the Commodity Import Program grants in Egypt the additional funds would have been many times this amount. We recommended that USAID/Egypt confer with the Government of Egypt regarding the desirability of placing Special Account funds into interest-bearing accounts at public and private sector banks. USAID/Egypt replied that the payment of interest on the Special Account could increase inflationary pressures, and Special Account balances were ample for Mission requirements.

AID policy requires that CIP grantees use the most favorable exchange rate, which is not considered unlawful, at the time of shipment if the importer is paying the full amount in cash, or at the time the 25-percent down payment is made if the importer wishes to pay on a longer term. For several years, USAID/Egypt and the GOE agreed to use the official rate announced by the Central Bank of Egypt for deposits to the Special Account. Higher rates existed that could have translated into substantial additional deposits. We made no formal recommendation on this matter. Eliminating the use of multiple rates in recipient countries , however, is a long-term objective of the AID Administrator and in May 1987 the Government of Egypt adopted a unified exchange rate. This higher rate had not yet been applied to Commodity Import Program transactions.

Office of Inspector General

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PART I - INTRODUCTION

A. Background

Between 1979 and 1986 the United States provided Egypt with more than $1.7 billion in grant funds under the Commodity Import Program and the Production Credit Project. Local currency generated from both activities was to be used for mutually agreed upon purposes. Section 609 of the Foreign Assistance Act of 1961, as amended and the Bilateral Assistance Agreement of 1978 between the United States and the Government of Egypt (GOE) required that:

> ...in cases, where commodities or services are furnished on a grant basis under arrangements which will result in the accrual of proceeds to the GOE from the import or sale of such commodities or services, the GOE will establish a special account and will promptly deposit the amount of local currency equivalent.

In accordance with these requirements, the Government of Egypt, in 1980 established a Special Account in its Central Bank for the local currency deposits. As of December 1986 there was a reported 439 million Egyptian pounds (about $325 million) in the account 1/.

AID policy encourages Missions to participate in the programming of foreign currencies in order to further local development activities. The USAID/Egypt and GOE "Memorandum of Understanding Regarding Special Account" dated June 30, 1980, as amended in 1986, set forth the mutually agreed upon uses for the funds which were principally for: (1) budget assistance to AID-financed projects and other developmental purposes as agreed; (2) activities in support of U.S.

1/ For deposits made prior to July 1986 the dollar equivalent presented in the report was converted at the official rate of about LE.84=$1. A fluctuating commercial bank rate of LE1.35 = $1 established in July 1986, was used for subsequent transactions. In May 1987, the GOE adopted a unified rate at about LE2.17 = $1.

economic assistance programs in Egypt; (3) establishment of a Small Scale Enterprise Credit Guarantee fund; (4) GOE personnel incentives; (5) administrative costs in support of USAID/Egypt; and (6) support of the Project Implementation Unit of the Ministry of Planning and International Cooperation. Withdrawals from the Special Account were made by the Ministry of Finance and reported on bank statements to USAID/Egypt. The Mission reviewed the transaction amounts in order to ensure that withdrawals were made as agreed.

As of June 1986, the Egyptian pound equivalent of $835 million had been deposited into a noninterest-earning account at the Central Bank of Egypt. The equivalent of $443 million had been withdrawn. Some CIP imports did not generate deposits to the Special Account. USAID/Egypt established "setasides" totaling about $117 million wherein nonrevenue-generating entities, such as universities, were allowed to import commodities without making local currency deposits.

The Special Account was the subject of critical audits by the AID Office of the Inspector General and the General Accounting Office (GAO). In 1980, the Office of the Inspector General concluded that USAID/Egypt had not effectively controlled amounts generated and deposited into the account; and implementing procedures for the establishment and management of the account had not been followed by either the GOE or by USAID/Egypt. The Office of the Inspector General recommended that USAID/Egypt coordinate with the GOE in implementing adequate internal controls over the account, enforce the submission of monthly bank statements, and design a computer subsystem to monitor local currency generations and deposits. Recommended improvements, however, were not fully implemented. In 1984, the GAO reported that Special Account deposits were not correlated to specific AID payment documents, the GOE had not complied fully with the requirement to set up a consolidated special account, and the Mission was unable to account for the use of millions of pounds in CIP-generated funds.

In response to the GAO audit, USAID/Egypt initiated a series of systems changes, starting in 1984, intended to improve accountability and management of the account. The GOE was required to design and implement an accounting system for collections, deposits, and disbursements. A Mission-operated, Counterpart Accounting System was instituted to augment the GOE's system and to allow for reconciliation of the account. Responsibility for implementing these improvements was placed on the GOE Ministry of Finance, the Ministry of Planning and International Cooperation, and the USAID/Egypt Office of Financial Management.

B. Audit Objectives And Scope

The audit was undertaken primarily to determine whether USAID/Egypt had resolved past problems over the accountability and control of Special Account funds. The objectives of this financial and compliance audit were to assess the adequacy of controls over: (1) the accountability and reconciliation of local currency funds collected and deposited into the Special Account; and (2) USAID/Egypt programming and utilization of account funds.

The audit was made at various USAID/Egypt offices, the Ministry of Finance, the Ministry of Planning and International Cooperation, the National Investment Bank, the Central Bank of Egypt, and public sector banks in Cairo. We reviewed public sector bank collection records for CIP Letters of Commitment and Letters of Credit disbursements totaling about $170 million, or about 21 percent of disbursements under CIP grant Nos. 263-K-604, 263-K-606 and 263-K-607 for the calendar years 1982 to 1984.

Special Account data collection procedures were evaluated, GOE bank deposit and withdrawal statements were analyzed, and USAID/Egypt and GOE government officials were interviewed. The report information on the reconciliation of USAID/Egypt and GOE financial records and arrearages was extracted mainly from the USAID/Egypt Arrival Accounting System and the Office of Financial Management records.

The audit focused on public sector transactions because most CIP proceeds were generated and collected through public sector entities, as well as on the prior audit findings of the AID Office of the Inspector General and the General Accounting Office. Audit procedures for verifying withdrawals from the account were applied only to project support withdrawals, which was the largest use of the funds.

The audit was made during the period from September to December 1986, and was done in accordance with generally accepted government auditing standards. The reviews of internal controls and compliance were limited to the findings in this report.

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PART II - RESULTS OF AUDIT

The audit showed that local currency collections and deposits into the Special Account were not adequately recorded and reconciled by the Government of Egypt. Local currency available in the Special Account was not effectively programmed and used.

After 1984, USAID/Egypt increased the emphasis on strengthening the processes for verifying and reconciling Special Account collections and deposits. Nevertheless, the audit showed that amounts were not being appropriately recorded and reconciled. Special Account funds were ineffectively programmed and used, and withdrawals were not traceable to specific end uses. The use of "setasides" diminished the amount of required deposits. Finally, Special Account funds were held at the Central Bank of Egypt in a noninterest-bearing account, thereby lessening the amount of local currency that otherwise could have been available for further development activities.

Six recommendations were made in the report. We recommended that USAID/Egypt require immediate deposit of all required proceeds if the GOE did not implement accounting procedures for Special Account collections and deposits. Increased Mission involvement and coordination in programming and using available local currency funds, establishing definitive ground rules for setasides, and consultation with the GOE concerning the desirability of placing Special Account funds into interest-bearing accounts were also recommended.

USAID/Egypt initiated some corrective actions in response to the report, but essentially disagreed with the recommendations.

A. Findings And Recommendations

1. The Government Of Egypt Did Not Properly Account For Special Account Collections And Deposits

The Government of Egypt did not implement agreed-upon accounting procedures for collecting and depositing local currency proceeds for the Special Account. Rather than requiring the Government of Egypt to fulfill the accountability responsibilities set out in Commodity Import Program Grant Agreements, USAID/Egypt regularly attempted to independently verify collection and deposit information with local banks. This time-consuming process enabled the Mission to calculate approximate balances in the account and to disclose the existence of arrearages by Egyptian importers. As of June 1986, about $81 million in arrearages was uncollected or unresolved. Without GOE implementation of the agreed-upon accounting procedures, USAID/Egypt could not verify all Commodity Import Program disbursements and all repayments by Egyptian importers. As a result, deposits into the Special Account could not be appropriately verified and reconciled.

Recommendation No. 1

We recommend that if the Government of Egypt does not implement the agreed-upon procedures in a timely and effective manner, USAID/Egypt require immediate deposit of all required proceeds by the Government of Egypt based on official reports of AID Commodity Import Program disbursements.

Discussion

In response to the 1984 GAO report, "AID Needs to Strengthen Management Of Commodity Import Programs" USAID/Egypt initiated a series of actions to remedy shortcomings in the accountability and management of the Special Account. Prior to 1984, the Mission gave a low priority to Special Account collections, deposits, and withdrawals.

In line with this increased attention, USAID/Egypt required the GOE to show evidence that an accounting system had been developed and implemented for collections, (including unpaid balances, if any), deposits, and disbursements of local currency generated under the 1984 grant agreement and all other CIP agreements.

This evidence was required before funds could be disbursed for the 1984 CIP grant agreement. To augment the expected GOE system, USAID/Egypt, in January 1985, initiated the Counterpart Accounting System. The Counterpart Accounting System was to be used in conjunction with the GOE manual accounting system to account for all prior and current CIP transactions.

USAID/Egypt also obtained the Ministry of Planning and International Cooperation (MPIC) agreement to collect importer arrearages which in September 1984, totaled more than LE117 million ($139 million) 1/. These actions included extra budgetary allocations to ministries enabling arrearages to be paid, and other steps to collect the arrearages, such as discontinuing allocations to importers who were behind in their payments.

The following sections of this finding describe USAID/Egypt's efforts to better manage and account for the Special Account proceeds. It shows that although improvements were made in verifying and reconciling collections and deposits, the problems could not be completely resolved, because GOE accounting and reporting procedures were not implemented as agreed upon.

GOE Accounting and Reporting Compliance

Ministerial Circular No. 8 dated December 1984 prescribed rules for ministries, governorates, government authorities, and public sector units to follow. These rules also covered repayments of local currency into the Special Account, including downpayments, and the issuance and payment of importer promissory notes. The Circular required public sector banks to submit detailed monthly reports for crucial

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1/ Importers usually placed a 25-percent deposit with a bank and agreed to make installment payments when due. Arrearages occur when importers: (a) do not make the required downpayment; (b) do not sign required promissory notes; or (c) fail to make installment payments when due. For report purposes dollar conversions prior to July 1986 were calculated at LE.84=$1. After July 1986 conversions were calculated at LE1.35=$1.

elements of CIP transactions. Private sector CIP transactions were governed by a different circular which prescribed similar rules for recording and reporting CIP collections and deposits.

The Central Bank of Egypt was to compile the bank reports and submit them through the Ministry of Finance to the USAID/Egypt Office of Financial Management. These reports were to provide Financial Management with the information needed to reconcile Special Account collections and deposits. The reports never materialized because the public sector banks did not adequately comply with the provisions of Circular No. 8.

In January 1985, USAID/Egypt management recognized that the manual GOE system of collecting and reporting transaction data lacked the flexibility of a computerized system, and was not producing the intended results. The Mission believed that the GOE system, if adequately implemented, was capable of capturing all the necessary CIP transaction information, thereby fulfilling the terms of the 1984 CIP grant agreement which required such a system before funds could be disbursed.

Few transaction reports were actually submitted as required. The reasons were not exactly clear. Ministry of Finance and Central Bank of Egypt officials advised us that attempts were made to obtain participating bank compliance with the Circular's reporting requirements; however, responses were sporadic, and reporting was incomplete. Bank officials at two participating public sector banks indicated that Circular No. 8 reporting was not being submitted, as required, because reporting requirements were not known, and/or reports were considered too time consuming to prepare.

Special Account Reconciliations

The Counterpart Accounting System established at USAID/Egypt to allow for reconciliation of the Special Account was dependent upon the continuous collection of data from local banks, and the receipt of current transaction information from the GOE accounting system. The Counterpart Accounting System incorporated details of USAID/Egypt's Arrival Accounting System regarding shipments of commodities received and disbursements to U.S. suppliers.

To compensate for the lack of GOE compliance in implementing the agreed-upon accounting procedures, the USAID/Egypt Office of Financial Management gathered most of its data for reconciling the account by visiting participating local banks. On all new CIP transactions and shipments recorded by the Arrival Accounting System, Office of Financial Management accountants verified importer downpayments and promissory note issuances. To determine whether outstanding promissory notes had been paid by Egyptian importers, the accountants compared Counterpart Accounting System amounts due for the period with bank statements submitted by the Ministry of Finance. Deposit figures collected from the banks were compared with deposits into the Special Account reported by the Ministry of Finance. This time consuming and difficult task was performed almost every quarter after September 1984.

In order to test the effectiveness of the Office of Financial Management's data collection process for account reconciliation purposes, the audit examined bank records for disbursements totaling about $170 million. The $170 million represented about 21 percent of the disbursements for CIP Grant Nos. 263-K-604, 263-K-606, and 263-K-607. The examination showed that the Office of Financial Management identified most deposits and promissory note issuances.

USAID/Egypt's Arrival Accounting system, however, did not provide complete information on all bank letters of credit opened and on all shipping documents supporting program disbursements. Thus, each quarter disbursements according to Arrival Accounting System records were between $97 and $175 million less than the disbursements reported by AID/Washington during the period. The basic incompatibility of the Arrival Accounting System and AID/Washington records of disbursements, along with missing or incomplete bank deposit statements from the Ministry of Finance, precluded accurate reconciliation of GOE deposits and AID disbursements for items shipped under the program.

Quarterly reconciliation variances between USAID/Egypt disbursement records and deposits reported by the GOE ranged from 1 percent to 14 percent of the amounts that presumably should have been deposited. The variances fluctuated considerably. The December 1985 reconciliation showed that deposits according to USAID/Egypt records, should have been LE14.8 million ($17.6 million) more than the deposits reported by the Central Bank. The June 1986 reconciliation showed that deposits should have been LE49.5 million ($58.9 million) less than Central Bank deposits, a difference of about LE64.3 million ($76.5 million) between the two periods.

Financial Management agreed that there were "gaps" in the Counterpart Accounting System, and that the system would never match reported GOE deposits. However, Financial Management felt that variances were low compared with total reported deposits. Also, under the system arrearages had been reduced and importers now were depositing local currency funds, as required.

To the credit of Financial Management, its reconciliation efforts did identify arrearages, and did induce payments by delinquent importers. After the September 1984 reconciliation, for example, arrearages were reduced by about $89 million, from LE117 million ($139 million) to about LE42 million ($50 million). However, additional delinquences surfaced later, as well as others which were not resolved by MPIC as agreed upon. Arrearages consequently averaged about LE42 million ($50 million) until the June 1986 reconciliation, when the amount increased to about LE68 million ($81 million).

According to Financial Management accountants, this increase was attributable primarily to newly identified "direct" letters of commitment transactions (about $24 million) that Financial Management could not verify as having been deposited into the Special Account. Additional unpaid transaction amounts were likely in view of the fact that the Counterpart Accounting System lacked complete verifiable information.

In sum, the GOE did not fulfill its responsibility to account for and deposit required local currency. Although USAID/Egypt engaged in a large-scale endeavor to account for deposits into the Special Account, system deficiencies in the Arrivial Accounting System base precluded reaching reasonable assurances that all required CIP and Production Credit project-generated local currency was deposited into the Special Account.

In view of the Government of Egypt's failure to put into place the accounting mechanisms needed to adequately account for and reconcile Special Account proceeds, USAID/Egypt should consider other options. Alternatively, the Mission should require full local currency deposits into the Special Account based on the values reported as paid to U.S. suppliers at time of shipments. Adoption of this procedure would place the burden of ensuring payments by importers on the Government of Egypt and relieve the Mission of the cumbersome responsibility of reconciling the account without adequate source records.

Management Comments

The Mission said that the reasons the GOE did not pay 100 percent of the local currency equivalent of the CIP imports at one time were its currency liquidity problem and budgetary deficits. The Mission said it would explore other ways of solving this problem, but that it was unwilling to impose unrealistic requirements for deposits which could only have the counterproductive effect of impeding dollar disbursements.

Office Of Inspector General Comments

The report recommendation addressed the unnecessary administrative burden placed on the Mission because the GOE could not, or would not, implement the agreed-upon accounting controls over Special Account deposits and withdrawals. Notwithstanding the Mission's concerns about liquidity and budget deficits, a Mission letter dated May 6, 1987 proposed to the GOE the following three ways in which new currency deposit procedures could be handled: (1) public sector importers would be asked to pay the full amount of the counterpart upon opening direct letters of commitment, (2) the Ministry of Finance, or the Ministry of Planning and International Cooperation (MPIC) on behalf of all importers would deposit on the basis of the W-214 disbursements during the preceding month, and (3) MPIC, or the Ministry of Finance would on behalf of all importers make deposits in three installments over a 2-year period; one-third upon signing the grant agreement and the balance in two equal deposits, one year and two years after the date of the grant signature. Each of these methods is responsive to our concerns and are worthy of further negotiations.

2. Special Account Funds Were Not Effectively Programmed And Used

Special Account funds, valued at about 439 million Egyptian pounds (about $325 million) as of December 1986, were not effectively programmed and used to support USAID/Egypt projects and other development activities. AID Policy Determination No. 5 encourages Mission participation in programming local currency generated by the sale of commodities when such involvement promises to help achieve developmental objectives. USAID/Egypt, however, was not involved early enough in the programming process to materially influence how Special Account funds could be effectively used. Protracted negotiations with the Government of Egypt over project support requirements shifted the focus from advance planning to reimbursing the Ministry of Finance for funds already spent. Moreover, most Special Account funds withdrawn for project use as mutually agreed to in the Memorandum of Understanding between the two countries, were commingled with other Government of Egypt resources. USAID/Egypt, therefore, lacked appropriate safeguards to ensure that projects actually received those funds.

As a result of ineffective programming of the funds, USAID/Egypt did not take advantage of the opportunity to expand development activity in Egypt with Special Account funds. In addition, USAID/Egypt spent millions of project support dollars for local currency without appropriate consideration of Special Account funds.

Recommendation No. 2

We recommend that USAID/Egypt maximize the use of Special Account funds through advance planning its fiscal year project support requirements with the Ministry of Planning and International Cooperation and the Ministry of Finance.

Recommendation No. 3

We recommend that USAID/Egypt, in conjunction with the Ministry of Planning and International Cooperation, identify new development areas that are not necessarily AID-financed projects, but which require local currency, and program currencies in excess of USAID/Egypt's needs for use in those areas.

Recommendation No. 4

We recommend that USAID/Egypt arrange with the Government of Egypt to establish a system whereby Special Account funds are transferred directly to accounts established solely for project support purposes.

Discussion

AID Policy Determination No. 5, "Programming PL 480 Local Currency Generations" (PD-5), also applies to Commodity Import Programs. It encourages AID participation in programming country-owned local currency generated by the sale of commodities, when such involvement promises to help in achieving developmental objectives. PD-5 further provides that when it is determined that AID should become more actively involved in the programming of local currency, the Mission should agree on the specific uses of the sales proceeds, as well as on the appropriate policy reforms.

The Memorandum of Understanding, between the Government of Egypt and USAID/Egypt, dated June 30, 1980, as amended in 1986, sets out six mutually agreed-upon uses for Special Account funds. About 89 percent of anticipated local currency equivalent deposits of $1.7 billion was allocated for budget assistance to AID-financed projects and other developmental purposes.

Central Bank of Egypt records showed that from inception through June 1986, an LE equivalent of about $350 million was withdrawn from the Special Account for AID-financed projects. USAID/Egypt, for the most part, did not take a proactive role in programming these funds nor did the Mission give adequate attention to additional developmental and other uses available for local currency, or ensure that funds withdrawn were actually used for project support purposes.

Programming Special Account Funds

Prior to 1984, USAID/Egypt was not involved in programming the use of Special Account funds. According to a December 1984 independent assessment of the Commodity Import Program In Egypt 1975-1984, USAID/Egypt policy appeared to lean toward the position that Special Account funds were GOE-owned and the GOE should be free to use those funds pursuant to its own development needs with little or no interference from USAID/Egypt.

In 1985, USAID/Egypt's involvement was limited to a Mission agreement to withdraw about LE158 million ($188 million) for USAID/Egypt projects listed by the GOE as requiring local currency support for the GOE fiscal year 1984-85.

The GOE submitted another list of local currency requirements for its fiscal year 1985-86. This list, dated February 1986, totaled about LE222 million ($264 million). According to the GOE, these funds had already been provided to projects by the Ministry of Finance from the general budget and needed to be refunded from the Special Account. Since the GOE fiscal year runs from July to June, the list of requirements dated February 1986 was submitted 8 months into the fiscal year.

In April 1986 the Mission presented MPIC a listing of its fiscal year 1986 needs totaling about LE158 million ($190 million). The Mission's list did not precisely match the projects listed by the Ministry of Finance in February of 1986. In view of the discrepancies in the listings, MPIC, in June 1986, authorized a Special Account withdrawal of LE32 million ($39 million) to fund AID-financed projects that appeared on both the Ministry of Finance and USAID/Egypt lists. Thus, the USAID/Egypt request was effectively reduced from $190 million to about $39 million 1/.

During this period, there were about LE329 million ($391 million) in the Special Account available to support both USAID/Egypt and the Ministry of Finance's local currency needs. The funds remained in the account; however, and USAID/Egypt spent millions of U.S. dollars to purchase local currency for its projects.

In June of 1986, for example, USAID/Egypt agreed to spend about $10 million in grant funds from the Alexandria Wastewater System Expansion Project (No. 263-0100) to pay local currency costs which were a GOE responsibility under the Grant Agreement. Mission management stated that the

1/ In September 1986, about 3 months into its next fiscal year, MPIC requested replenishment from the Special Account of about LE130 million ($96 million) for support provided projects in the GOE fiscal year 1986-87. USAID/Egypt reacted in early December 1986 by proposing an allocation of about LE263 million ($194 million) from the Special Account. As of March 1987, the issue of Special Account funding had only been partially resolved. The GOE fiscal year ends in June 1987.

continued success of the project depended on quick use of AID grant dollars to clear the arrearages due Egyptian subcontractors, and to fund the U.S. contractor's direct costs. Timely consideration of using Special Account funds may have precluded the need for spending U.S. dollars.

Another example involved the Safaga Grain Silos Project (No. 263-0165). Under the project, USAID/Egypt agreed to spend $6.5 million to finance power generators to assure full capacity operation of the grain silos complex, even though the power source expenditures were the GOE's responsibility.

Additionally, during the period July 1986 to June 1987, USAID/Egypt proposed to convert about $115 million to Egyptian pounds for use on AID-financed projects and continued to expend dollars for Mission operating costs.

We requested that USAID/Egypt explain why dollars were being used for local currency needs instead of pursuing with the GOE the possible use of Egyptian pounds from the Special Account. The Mission agreed millions of dollars would be saved by substituting Egyptian pounds for U.S. dollars, but said these dollars would simply be obligated for other purposes anyway. It is worth noting that some USAID/Egypt officials believe that the political context of the AID program in Egypt requires all appropriated funds be spent. With this perspective, it is advantageous to both parties to spend dollars instead of pounds from the Special Account.

As of December 1986, there were about LE438.5 million ($325 million) available that could be used for Egypt's developmental needs, and/or to possibly reduce USAID/Egypt dollar expenditures.

<u>Special Account Funds Withdrawn for Project Support</u>

From an accounting viewpoint, funds earmarked for specific purposes such as for project support assistance are more effectively controlled when they retain their specific identity with the intended purpose. On this matter the House Appropriations Committee commenting on the fiscal year 1987 AID Appropriations Act, said "...The Committee strongly believes that all ESF dollar cash transfers and <u>generated local currencies</u> should be easily trackable and should not <u>be commingled</u> with other funds. (Underscoring added.)

As of June 1986, according to Central Bank records, about LE294 million ($350 million) had been withdrawn from the Special Account for the purpose of supporting AID-financed projects. Most withdrawals were commingled with other GOE resources, presumably to reimburse the GOE for project support expenses which had already been incurred. USAID/Egypt lacked a system for verifying the actual expenditures of funds in support of the projects. Indeed, the Mission could not ensure that the funds had actually reached the intended projects.

To illustrate, in December 1985 the Office of Financial Management attempted to verify the transfer of LE158 million ($188 million) from the Special Account to USAID/Egypt-financed projects. Several project officers responded that funds from the Special Account were not identifiable. Others reported "zero" funds were received, or did not respond to the request for information. As a result, only LE16 million, about 10 percent, ($19 million) was indicated as actually reaching USAID/Egypt-financed projects. One project, the Safaga Grain Silos Project, was supposed to receive LE10.2 million ($12 million) in 1985. According to project management and Egyptian counterpart officials, no local currency project funds were received during the budget year. Ironically, no funds were requested in 1986, and USAID/Egypt agreed to finance power generators costing about $6 million with U.S. dollars.

In sum, USAID/Egypt needs to become more involved in programming available Special Account funds in order to possibly increase development activities in Egypt and to conserve U.S. dollars. Its involvement needs to take place before the GOE budget is fixed so that project requirements can be incorporated into the ministries' annual determinations on local currency levels. USAID/Egypt also needs better mechanisms for ensuring that funds withdrawn for project support are distributed to projects as agreed upon. A way to accomplish this is to transfer funds directly to accounts established solely for project support purposes.

Management Comments

The Mission said the recommendation to do advance planning to allocate Special Account funds prior to the start of the Egyptian fiscal year had merit, if it could be implemented. It said the GOE budgeting cycle makes it almost impossible to finalize the Special Account allocation prior to the start of the GOE fiscal year on July 1. The Mission said it would continue to push the GOE for early allocation; however, it will probably not be done prior to the start of the GOE fiscal year.

Office Of Inspector General Comments

The recommendation was that the Mission maximize the use of Special Account funds by advance planning its project support requirements, not that the actual allocation necessarily had to take place prior to the start of the Egyptian fiscal year.

In the past, the Mission has not made its needs known until the GOE fiscal year had started and after the budget was fixed. Long negotiations then pushed the final decisions on allocations well into the fiscal year, so that the agreed upon amounts for project support turned out to be retroactive payments for expenditures already made by the GOE. The Mission needs to plan for its local currency needs before the start of the GOE fiscal year and to provide planning information to the GOE so the Mission's needs can be considered while the GOE budget is being formulated. This would allow early agreement on project support levels.

Management Comments

The Mission said the recommendation to explore with the Ministry of Planning and International Cooperation new areas to be financed from the Special Account, to the extent practical, had already been implemented. It said there were occasional possibilities for such programming, but in general the Mission's policy was to concentrate staff resources on its first priority--proper stewardship of AID's appropriated dollars, rather than GOE-owned Egyptian pounds.

Office Of Inspector General Comments

The Mission's attempts to use Special Account funds, other than its annual request for allocations to support AID-financed projects, have not reflected any systematic approach to using the funds for development purposes. Egypt's needs provide enormous additional opportunities for the use of the funds. The parties should identify those needs and agree on funding levels.

Additional uses of Special Account funds need not unduly increase demands on Mission resources. Special Account funds are a highly desirable complement to the dollars made available for development purposes. The Mission should accord appropriate priority to the use of these funds.

Management Comments

The Mission said the recommendation to require the GOE to transfer funds from the Special Account directly to the recipient projects confuses the need for Special Account funds to be spent for mutually agreeable developmental activities of whatever nature, with the need that the GOE contributions to bilateral projects be timely forthcoming. It said both of these needs can be fully satisfied, in the Mission's judgment, without imposing segregated bank and detailed tracking requirements on GOE agencies.

Office Of Inspector General Comments

The Mission lacks the capability for tracking actual disbursements of funds from the Special Account and ensuring that project local currency requirements are met. The recommendation that funds be transferred directly to recipient projects is intended to ensure that projects receive the support agreed to by the parties and to provide a basis for verification, if necessary. The recommendation does not deal with the question of host country contributions; however, it is consistent with recommendations made in the audit report, "Controls Over Government Of Egypt Contributions To USAID-Financed Projects In Egypt" No. 6-263-87-4 dated March 12, 1987. Dedicated accounts have already been established by the Ministry of Finance and the Mission for certain projects and these have proven to be effective. A wider use of such accounts as contemplated by the recommendation should also prove worthwhile.

3. "Setasides" Were Exempted From Deposit Requirements Without Sufficient Justification

Commodity Import Program "setasides" totaling $117 million exempted certain importers from depositing local currency into the Special Account. Mainly, these importers were not revenue-generating activities and, therefore, not subject to deposit requirements. These setasides, however, were made without clear USAID/Egypt ground rules and legal justification for exempting such transactions from the deposit requirements. Section 531(d) of the Foreign Assistance Act of 1961, as amended, requires that commodity import local currency generations be maximized. As a result of the setasides, potential deposits to the Special Account may have been inappropriately excluded.

Recommendation No. 5

We recommend that USAID/Egypt establish definitive ground rules for setasides that comply with Section 531(d) of the Foreign Assistance Act of 1961, as amended.

Discussion

Section 531(d) of the Foreign Assistance Act provides that to the maximum extent feasible, funds made available for CIP programs or other program assistance shall be used to generate local currencies. Grant agreements with the Government of Egypt, however, exempted certain importers from depositing local currency into the Special Account. Specifically, CIP grants for fiscal years 1979 through 1986 provided that USAID/Egypt and the GOE could agree in implementation letters under which setasides would not result in the accrual of proceeds to the GOE, and thus not require deposit into the Special Account.

Since 1979, about $117 million or about 6.4 percent of expected CIP grant disbursements were setasides. These setasides were generally authorized to GOE ministries, governorates, universities, and public service companies. There were no formally written ground rules, such as those usually found in AID Handbooks or Mission Orders, for authorizing setasides. Nor could we find authorization in the Foreign Assistance Act of 1961, as amended, for doing so. Mission management said that setasides were restricted to entities that were nonrevenue-generating and provided an essential public service such as government laboratories, universities, and the like. The audit showed that this was not always the case.

For example, the Project Assistance Approval Document (PAAD) for AID Grant No. 263-K-607, fiscal year 1984, mentioned that tightening in credit terms had caused some GOE entities to seek setaside relief out of an alleged inability to meet the new credit terms. The PAAD indicated that USAID/Egypt had refused an application for relief from the Cairo Airport Authority on the grounds that it was a revenue-making entity. The refusal was reversed in January 1986, and a setaside was authorized for $5.2 million. The basis for the reversal in position was that the funds would be used for screening and safety equipment and would not result in the accrual of proceeds to the recipient.

The audit disclosed several other questionable setasides that were granted to GOE revenue-generating activities. At least $13 million was provided to public sector service companies for commodity purchases. These purchases included generators and spare parts for a power plant and circuit breakers and other equipment for the Egyptian Electric Authority, as well as spare parts for trucks and buses for the Ministry of Transportation.

During the audit, the USAID/Egypt Legal Office was asked whether the allowance of setasides complied with Section 531(d) of the Foreign Assistance Act of 1961, as amended. The Legal Office replied that the Mission had complied with the requirement of the Act because the setaside authority was invoked in a small proportion of the overall CIP program, and it was fair to say that "to the maximum extent feasible" the Mission had used the CIP to generate local currency as envisioned by Section 531(d).

Setaside provisions in CIP grants, in our view, are questionable and may be contrary to the intended purpose of maximizing local currency generations from funds made available under the CIP. Additionally, without proper control setasides can be used to bypass the intended purpose of the Act and the USAID/Egypt-GOE Bilateral Agreement requirements that proceeds derived from CIP grant transactions will be deposited into a Special Account.

In summary, setaside provisions are questionable and may be contrary to legislative intent. Definitive ground rules consistent with Section 531(d) of the Act would clarify when it was appropriate to use setasides and to forego the local currency deposit requirement of the Act.

Management Comments

The Mission said counterpart funds need not be generated in 100 percent of CIP transactions, but rather some reasonable flexibility is left to the Agency to decide in specific cases about requiring generations of counterpart. It did not think a special Mission Order was needed on this point.

Office Of Inspector General Comments

The report recognizes the Mission's need for flexibility and that a relatively small percentage of expected CIP grant disbursements were setasides. The use of setasides without appropriate controls, however, can result in non-compliance with the intended purposes of Section 531(d) and USAID/Egypt-GOE Bilateral Agreement. No written Mission ground rules exist for the use of the setaside authority. Establishing definitive "setaside" guidelines can assist the Mission maintain proper control over the use of the exemption authority.

4. The Use Of Special Account Funds To Generate Interest Could Substantially Increase Available Local Currency

Local currency proceeds were deposited into a noninterest-bearing Special Account at the Central Bank of Egypt. AID policy suggests that Missions consider the deposit of such proceeds into interest-bearing accounts at commercial banks to help finance development activities, but USAID/Egypt did not pursue such a policy for some unexplained reason. If the Special Account balance on deposit in December 1985 had accrued interest at 9 percent for one year, additional funds totaling about $19.5 million could have been generated for developmental uses. Over the life of Commodity Import Program grants in Egypt the additional funds would have been many times this amount.

Recommendation No. 6

We recommend that USAID/Egypt, in consultation with the Government of Egypt, determine the desirability of placing Special Account funds, in excess of immediate needs, into interest-bearing accounts at public and private sector banks.

Discussion

AID Policy Determination No. 5, "Programming PL 480 Local Currency Generations", states that:

> "Missions should consider depositing the sales proceeds into an interest bearing commercial bank account established to help finance development activities not agreed upon during negotiations or not yet ready for implementation; both the principal and the interest can later be used for funding such activities."

CIP-generated proceeds on deposit in the Special Account at the Central Bank of Egypt did not earn interest. In October 1986, we asked the USAID/Egypt Office of Financial Management to explain why Special Account funds were kept in a noninterest-bearing account. The Office of Financial Management could not give us an answer. It said that the question had been referred to the Central Bank of Egypt, the Ministry of Finance, and the MPIC. Official replies were later received from the GOE, but the replies were not very detailed and seemed to imply only that the GOE must keep its funds at the Central Bank of Egypt which pays no interest. In any event, the Mission said it did not find this a disturbing situation. It said the Special Account at 400 million Egyptian pounds was ample to meet any possible requirements of the AID program, within current programming practices, and that interest was unnecessary for AID purposes.

If Special Account funds totaling LE182,144,000 on deposit in December 1985 had been placed into an interest-bearing account, about LE16.4 million ($19.5 million) in interest (assuming an interest rate of 9 percent) would have been earned in one year. Over the life of Commodity Import Grants the additional funds would have been many times greater than this amount. These funds could have enhanced AID's objectives by being used for additional developmental purposes. Or, the additional funds could have reduced overall Egypt program outlays and allowed more financial resources to be used elsewhere.

Management Comments

The Mission said to ask the GOE to pay interest on the Special Account would amount to paying interest to itself which would create excess liquidity resulting in increased inflationary pressures. Furthermore, the present balance is more than ample for Mission requirements.

Office Of Inspector General Comments

The recommendation was that the Mission confer with the GOE on the desirability of placing Special Account funds into interest bearing accounts at public and private sector banks not that the GOE pay interest to itself. AID policy encourages the deposit of local currency from commodity sales into interest bearing accounts. This policy is implemented in other AID Missions such as in Latin America and in the Gambia. The Mission response was not persuasive in explaining why the recommendation should not be implemented in Egypt. The reason the balance in the account is so high is because the Mission and the GOE have not aggressively pursued possible uses of the money for development purposes.

B. Compliance And Internal Control

Compliance

In the areas audited, compliance exceptions were as follows: (1) the Government of Egypt did not implement required accounting procedures to record and report counterpart collections and deposits into the Special Account (Finding 1); and (2) setasides exempting certain importers from depositing counterpart funds into the Special Account appeared to be contrary to the Foreign Assistance Act of 1961, as amended, Section 531(d) (Finding 3).

Internal Control

The audit disclosed the following internal control weaknesses:

(1) Due to insufficient GOE accounting control systems for the collection and deposit of counterpart funds, actual required deposit amounts in the Special Account are not known, and substantial amounts remain uncollected and undeposited (Finding 1);

(2) USAID/Egypt did not have a control procedure for verifying that withdrawals from the Special Account for project support actually reached the projects (Finding 2).

The review of internal controls was limited to the finding areas discussed in this report.

C. Other Pertinent Matters

1. Exchange Rate Used For Computing Counterpart Deposits

AID policy requires that CIP grantees use the most favorable exchange rate, which is not considered unlawful, at the time of shipment if the importer is paying the full amount in cash, or at the time the 25-percent down payment is made if the importer wishes to pay on a longer term.

For several years, USAID/Egypt and the GOE agreed to use the official rate announced by the Central Bank of Egypt for deposits to the Special Account. Higher rates existed that could have resulted in substantial additional deposits. Since July 1, 1986, for example, the rate used for private sector importers under the Commodity Import Program has been US $1=LE1.35. For public sector importers the rate used has been US $1=LE1.35 minus a 10-percent discount (LE.13), or LE1.22. At July 1, 1986, the market rate at which commercial transactions take place was fluctuating around US $1=LE1.95, a difference of about 45 percent and 60 percent for private and public sector importers, respectively. During the period July 1, 1986, through December 31, 1986, deposits computed at the higher rate would have meant an additional LE64 million ($33 million) in the Special Account.

In November 1986, the AID Administrator advised the Chairman, of the House Subcommittee on Legislation and National Security, Committee on Government Operations that AID's long-run objective is to have one unified market determined exchange rate for all transactions in each country in which we work. A multiple rate structure existed in Egypt at the time the audit was made.

We made no official recommendation on this matter. It was included in this report to indicate the apparent inconsistency with overall Agency policy regarding the use of most favorable exchange rates, particularly in the area of permitting public sector importers a 10-percent discount on local currency repayments. In May 1987 the GOE unified the exchange rates at about LE2.17; however, agreement had not been reached with the GOE on whether this rate would be applied to CIP transactions.

AUDIT OF
;AID/EGYPT CONTROLS OVER THE SPECIAL ACCOUNT

PART III -APPENDICES

25

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

MISSION EGYPT

MAY 13 1987

MEMORANDUM

MAY 14 REC'D

TO: Joseph Ferri, RIG/Cairo

FROM: Arthur Handly, Acting Director

SUBJECT: Mission's Response to the Draft Report on the Audit of USAID/Egypt Controls over the Special Account

Before responding to six specific recommendations made in the report, the mission would like to draw attention to several deficiencies noted in the text of the report.

1. The report has failed to give due credit to the establishment and operation of the Counterpart Accounting System by the controller's office of the USAID. This system, in spite of its shortcomings, has provided accountability for the counterpart funds generated by the CIP program and has enabled the mission to have a mechanism in place whereby delinquent importers are identified and denied further CIP allocations until their arrearages are paid up. (See Item 1, Office of Inspector General Footnotes)

2. The report fails to recognize the progressively aggressive role played by USAID in jointly programming the funds deposited in the Special Account. On the contrary, the report wrongfully places the blame on USAID's shoulders for slow disbursements of the Special Account funds. Since 1985, the mission has been progressively more actively involved in channelling the Special Account Pounds to assist USAID projects. (See Item 2, Office of Inspector General Footnotes)

3. The report goes completely off the mark when it proposes that the mission track the allocated Special Account Pounds down to the Project level. There are no AID requirements that USAID should replicate dollar accounting procedures for Special Account uses. To do that would be tremendously staff intensive, to the extent of requiring additional staff, and would not be cost effective. Instead, USAID has implemented its monitoring responsibility by being actively involved in the decision making process to allocate funds and thereafter accepting the GOE's system of filtering those funds down to projects through the Central Bank and the National Investment Bank. It should be pointed out that this global method of monitoring results was the result of an informed management decision, not something that happened by default. (See Item 3, Office of Inspector General Footnotes)

4. The exchange rate question continues to trouble the auditors. AID policy in Egypt, long ago embodied in the Bilateral Agreement, and incorporated in all CIP Grant Agreements through the years, has been to insist on the highest official rate (currently about 1.36) as opposed to the "highest rate which is not unlawful" (currently about 2.12). As the draft audit report notes, however, we are hopeful, eventually, of seeing a unified exchange rate. (See Item 4, Office of Inspector General Footnotes)

5. Confusion continues, it seems, with respect to Impoundment Act procedures. It is incorrect to ascribe (pp. 22-23) to "some USAID/Egypt officials" a belief that "the political context of the appropriated funds be spent". Rather, the need to obligate all appropriated funds, within the Egypt earmark, is mandated by legislature. The option to obligate, under the legislation, is to follow special Congressional Notification procedures which come into play only if the President determines that appropriated funds are unnecessary to achieve the underlying purposes. This is not the case with the Egypt program. See Mr. Kimball's memo to you of March 31, 1987 for elaboration. (See Item 5, Office of Inspector General Footnotes)

Responses to Recommendations:

No. 1 - Recommendation No. 1 directs the mission to require the GOE to deposit the full amount of the equivalent local currency of CIP imports, if the GOE fails to install the accounting system agreed to in 1985.

The auditors fail to understand that the reason for non-payment by the GOE of 100% of the local currency equivalent of the CIP imports at one time, is the local currency liquidity problem and budgetary deficits faced by the GOE. Installation of an accounting system will not eliminate the GOE's budget deficits. The mission will explore other ways of solving this problem of the GOE accountability of the Special Account Deposits. However, we are unwilling to impose unrealistic requirements as to Special Account deposits which could only have the counter-productive effect of impeding dollar disbursements. (See Office of Inspector General Comments, Page 10)

No. 2 - This recommendation asks the mission to do advance planning to allocate Special Account funds prior to the start of the Egyptian fiscal year. The suggestion has merits if it can be implemented. However, the current system of the GOE Budgeting cycle makes it almost impossible to finalize the Special Account allocation prior to the start of the GOE fiscal year. USAID has worked diligently to reduce the time gap between the start of the GOE fiscal year and the actual allocation of Special Account Funds. For example, during the last year, this process was initiated in August 1986,

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the earliest it could have begun. We will continue to push the GOE for early allocation, however, under the present GOE budget cycle, it will probably not be done prior to the start of the GOE fiscal year, (July 1, 19__). (See Office of Inspector General Comments, Page 16)

No. 3 - This recommendation asks the mission to explore with MPIC new areas to be financed from the Special Account deposits. To the extent practical, this recommendation has already been implemented. During the current round of negotiations with MPIC, USAID has agreed that after allocating funds to finance the needs of AID financed projects, administrative costs (Trust Funds) and other known AID requirements, the balance can be used for activities like basic human needs, etc. which are traditionally supported by AID. There are occasional possibilities for fairly close programming of local currency [e.g., the Small Scale Credit Guarantee Fund and our recent support of the zabaleen (garbage men)]. In general, however, current mission's policy, with due acknowledgement of PD-5, is to concentrate its staff resources on clearly the first priority: proper stewardship of AID's appropriated dollars rather than GOE-owned LE. This recommendation should be closed. (See Office of Inspector General Comments, Page 16)

No. 4 - This recommendation wants USAID to require the GOE to transfer funds allocated from the Special Account directly to the recipient projects. This recommendation confuses the need for Special Account funds to be spent, eventually for mutually agreeable developmental activities of whatever nature, on the one hand, with the need that the GOE contributions to bilateral projects be timely forthcoming, on the other hand. We have addressed this latter need in the context of RIG/A's recent audit of Host Country Contributions. The former need we are continuing to address, as shown above. Both of these needs can be fully satisfied, in the Mission's judgement, without the imposition of segregated bank accounts and detailed tracking requirements on GOE agencies. This recommendation should be dropped. (See Office of Inspector General Comments, Page 17)

No. 5 - This recommendation asks USAID to document ground rules to determine set asides. The applicable legislation - Section 531(d) of the FAA - merely requires that, "to the maximum extent feasible", CIP funds be used to generate counterpart. On face of this language, obviously, counterpart need not be generated in 100% of CIP transactions but rather, some reasonable flexibility is left to the Agency to decline, in specific cases, to require generations of counterpart. In fact, in Egypt through the years, counterpart has been generated in 93.4 percent of the cases. Criteria for waiver - "set asides" - have at times been addressed in PAADs and at times _ad hoc_ during program implementation. A normal criterion would be whether the end-user is profit-generating or not. We reserve the right to consider other criteria. We do not think we need a special Mission Order on this topic. If RIG/A continues to think this practice of the Mission's is "questionable" or that it "may be contrary to legislative intent", we request elaboration. Otherwise, this recommendation should be closed. (See Office of Inspector General Comments, Page 20)

No. 6 - This recommendation asks USAID to confer with the GOE regarding the desirability of keeping the Special Account funds in an interest bearing account.

It is necessary to understand the nature of the CIP transactions when addressing this issue. Imports under the public sector CIP are 'paid for' by the public sector companies through a GOE 'budget allocation'. Those 'payments' are made to a GOE entity - the Central Bank - which 'holds' these funds until 'utilized'. When these funds are 'utilized' they are transferred to the allotees for fulfilling their 'budget allocation'. This whole excercise ultimately results in decreasing the budgetary deficits of the GOE.

To ask GOE to pay interest on the Special Account would amount to paying interest to itself which would create excess liquidity resulting in increased inflationary pressures. Furthermore, the Special Account now amounts to more than LE 400 million. This is more than an ample call for USAID - through the requirement that we approve releases and expenditures - to have on GOE-owned assets.

This recommendation, being non-implementable, should be closed. (See Office of Inspector General Comments, Page 22)

Clearances: PPP:Jonathan Conly (In Draft)
SLA:Kevin O'Donnell (In Draft)
D/AD/IS:Paul O'Farrell (In Draft)

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Office Of Inspector General Footnotes To Mission's Response To Draft Report

1. The report on pages 5, 6, 9 et al gives appropriate credit to the Mission's establishment and operation of the Counterpart Accounting System. The system has achieved an "order of magnitude" accountability over Special Account deposits and withdrawals. It was never intended, however, to substitute for the overall GOE control requirements contained in Commodity Import Program grant agreements.

2. The Mission has taken some actions recently that indicate more interest in using Special Account funds. Other Mission actions, however, such as limiting the use of such funds primarily to AID-financed projects and not developing a comprehensive program for development activities indicate that any new uses of the funds are marginal in terms of the resources available. (See Office of Inspector General Comments, page 16, for additional comments.)

3. The Mission's attempt in December 1985 to verify that projects received the funds transferred from the account indicated that only about 10 percent of the total could be verified as having reached the projects. The present system, therefore, gives USAID/Egypt little assurance that the mutually agreed upon purposes for the use of funds are being met.

Tracking the use of funds would not be labor intensive. The system proposed in the report of direct transfers to accounts identified with the projects would be a paperwork transaction. The system would provide a basis for knowing whether projects received the funds agreed to and could be easily verified. (See Office of Inspector General Comments, page 17, for additional comments.)

4. The exchange rate question continues to be troublesome because it is not certain what rates will apply to transactions affecting the Mission. In May 1987 the official exchange rate was changed to about LE2.17. This new rate is supposed to apply to CIP transactions, but as of the time of the Mission's comments, Mission management could not assure this would be the case. Further, it was unclear whether public sector importers would continue receiving a 10 percent discount, or some similar adjustment, to compensate for the higher cost of importing U.S. products. Agreement should be reached on these questions and applied to the CIP.

5. Impoundment Act procedures are self-explanatory. The context of the report statement is that some Mission officials believe that expending Special Account funds could be counterproductive to the objective of spending the U.S. dollars earmarked for Egypt. We view the funds as essentially complementing Egypt program levels and as a possible source for reducing dollar expenditures for project support costs.

List Of Recommendations

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Recommendation No. 1 5

We recommend that if the Government of Egypt does not implement the agreed-upon procedures in a timely and effective manner, USAID/Egypt require immediate deposit of all required proceeds by the Government of Egypt based on official reports of AID Commodity Import Program disbursements.

Recommendation No. 2 11

We recommend that USAID/Egypt maximize the use of Special Account funds through advance planning its fiscal year project support requirements with the Ministry of Planning and International Cooperation and the Ministry of Finance.

Recommendation No. 3 11

We recommend that USAID/Egypt, in conjunction with the Ministry of Planning and International Cooperation, identify new development areas that are not necessarily AID-financed projects, but which require local currency, and program currencies in excess of USAID/Egypt's needs for use in those areas.

Recommendation No. 4 12

We recommend that USAID/Egypt arrange with the Government of Egypt to establish a system whereby Special Account funds are transferred directly to accounts established solely for project support purposes.

Recommendation No. 5 18

We recommend that USAID/Egypt establish definitive ground rules for setasides that comply with Section 531(d) of the Foreign Assistance Act of 1961, as amended.

Recommendation No. 6 21

We recommend that USAID/Egypt, in consultation with the Government of Egypt, determine the desirability of placing Special Account funds, in excess of immediate needs, into interest-bearing accounts at public and private sector banks.

APPENDIX 4

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