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AUDIT OF
INCOME GENERATING PROJECTS
Audit Report No. 6-263-88-4
May 19, 1988

UNITED STATES GOVERNMENT

memorandum

DATE: May 19, 1988

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

Joseph R. Ferri

SUBJECT: Audit Of Income Generating Projects

TO: Mr. Marshall D. Brown, Director USAID/Egypt

The Office of the Regional Inspector General for Audit, Cairo has completed its audit of USAID/Egypt's Income Generating Projects. Ten copies of the audit report are enclosed for your action.

A draft of this report was submitted to you for comment. The Mission's response is excerpted at the end of each finding section and is included, as appropriate, in Appendix 1 to the report. The report contains eight recommendations. Recommendation No. 7 is considered closed and requires no further action. Recommendation Nos. 4 and 8 are resolved and will be closed upon completion of the planned or promised actions. Recommendation Nos. 1, 2, 3, 5, and 6 are unresolved but Mission actions are underway or proposed for each. Please advise this office within 30 days of any additional actions taken or contemplated to implement these recommendations.

We appreciate the cooperation and courtesy extended to our staff during the audit by project officials in the Office of Health and the Office of Population.

EXECUTIVE SUMMARY

USAID/Egypt's Population and Control of Diarrheal Diseases projects generated over $1 million per year of project income from the public sector distribution of A.I.D.- and non-A.I.D.-financed contraceptives and oral rehydration salts sold to the general public. A.I.D. costs to acquire contraceptives since 1977 and rehydration salts since 1981, for the public sector delivery system, totaled $8.2 million and $3.2 million, respectively.

The objectives of this economy and efficiency audit were to determine if: (1) Government of Egypt implementing agencies were properly accounting for and controlling project income; (2) revenues were being used effectively; and (3) price, source, and origin controls were effective in the procurement of A.I.D.-financed local products acquired for resale.

The audit showed that USAID/Egypt's cost recovery initiatives had developed substantial income that offset some of its costs of providing commodities for public sector population and diarrheal diseases control activities. There were, however, material management control weaknesses over the income on the part of USAID/Egypt, and Government of Egypt implementing agencies.

USAID/Egypt, for example, did not establish effective systems for overseeing cost recovery activities. The National Population Council and the National Control of Diarrheal Diseases Project were responsible for implementing the projects for the Government of Egypt, and had the semblance of systems for controlling project income. These offices, however, did not properly account for, control, and use proceeds from sales of the A.I.D.-financed commodities. In addition, the National Control of Diarrheal Diseases Project had not established controls to ensure that A.I.D. price, source, and origin requirements were met for locally produced oral rehydration salts. The specific audit findings are provided in the following paragraphs.

More than $2 million from public sector sales of A.I.D.-financed contraceptives under the Population - Family Planning projects were not segregated and used for mutually agreed upon project purposes. We recommended that USAID/Egypt enter into a revenue agreement with the Government of Egypt covering several aspects for project income generated from this source. USAID/Egypt generally agreed with the recommendation and was negotiating a new agreement.

At least $701,000 from public sector sales of family planning devices to pharmacies was not remitted to the National Population Council, the cognizant Government of Egypt office. Instead, the National Population Council's distributor, the Egyptian Pharmaceutical Trading Company, kept the funds and used them in its commercial operations. We recommended that USAID/Egypt facilitate a written agreement between the Egyptian Pharmaceutical Trading Company and the Ministry of Health on the collection and use of funds; an accounting be made of funds collected; and a system be set up for comparing collections with contraceptive issues from warehouses. USAID/Egypt generally agreed with the recommendations and started to implement them.

About $2 million of income from the sales of oral rehydration salts over a 3-year period, under the Control of Diarrheal Diseases Project, was left to accumulate in a non-interest-bearing commercial bank account with no agreement as to how the funds would be used. We recommended that USAID/Egypt issue implementation letters to authorize spending the project income for mutually intended purposes; establish budgeting, accounting, and reporting systems; transfer the funds to an interest-bearing account; and change the present method of financing A.I.D. advances until idle funds are reduced to an acceptable level. While the audit was in process, USAID/Egypt established the recommended systems and started using the accumulated funds, fulfilling part of the recommended action. Responsive to the recommendation, USAID/Egypt also agreed to make further uses of the funds generated and to advise the National Population Council to use an interest-bearing account.

USAID/Egypt paid $261,518 in excess of official exchange rates for commodities imported for oral rehydration salts production. We recommended that USAID/Egypt establish a system for reviewing line-item costs; obtain proper Mission clearances for noncompetitive contracts; and advocate that the highest official rate of exchange be provided for A.I.D. Based on the audit, USAID/Egypt advised the Government of Egypt that A.I.D. funds could not be used to pay foreign exchange rate differences. USAID/Egypt generally agreed with the recommendations and proposed actions that were positive and responsive.

USAID/Egypt purchased $3.2 million of oral rehydration salts under the Control of Diarrheal Diseases Project from a monopoly parastatal supplier in Egypt, without benefit of a cost analysis to support the price. We recommended that

USAID/Egypt obtain a production cost analysis to further establish the reasonableness of prices paid before approving future contracts. USAID/Egypt generally agreed with the recommendation and initiated actions that were responsive.

Regarding other pertinent matters, USAID/Egypt did not have measures in effect to ensure that A.I.D. source and origin requirements were met for oral rehydration salts purchases. We suggested that USAID/Egypt obtain and examine importers' inspection certificates from local suppliers and establish a system for obtaining certifications on future invoices. USAID/Egypt indicated that if future procurements were funded by A.I.D. it would insist that source and origin certificates be provided.

Office of the Inspector General

AUDIT OF
INCOME GENERATING PROJECTS

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ALPHABETICAL LISTING OF ACRONYMS

A.I.D.	Agency for International Development
CID	Chemical Industries Development
EPTC	Egyptian Pharmaceutical Trading Company
FOF	Family of the Future
GOE	Government of Egypt
MOH	Ministry of Health
NCDDP	National Control of Diarrheal Diseases Project
NPC	National Planning Council
RIG/A/C	Regional Inspector General for Audit, Cairo
Salts	Oral Rehydration Salts
USAID/Egypt	Agency for International Development Mission in Egypt

AUDIT OF
INCOME GENERATING PROJECTS

PART I - INTRODUCTION

A. Background

Two A.I.D.-supported activities with public sector organizations in Egypt generated an average of over $1 million per year of project income during the period July 1, 1983, through June 30, 1987. 1/ These activities involved USAID/Egypt projects with the Government of Egypt (GOE) in which A.I.D.-financed and non-A.I.D.-financed contraceptives and A.I.D.-financed oral rehydration salts were sold to the general public.

Under the Population-Family Planning activity, Projects 263-0029 and 263-0144, A.I.D.-furnished contraceptive devices were sold through the public sector office, the National Planning Council (NPC). The public sector distributor, Egyptian Pharmaceutical Trading Company (EPTC), sold condoms, intrauterine devices (IUDs) and vaginal foaming tablets, to an estimated 7,000 private pharmacies and a reported 3,960 GOE-operated family planning units, including 3,300 Ministry of Health (MOH) units, 510 Egyptian Family Planning Association units, and 150 other units under the jurisdiction of Governorates or Ministries. A private sector organization, Family of the Future (FOF), also sold similar contraceptive devices to private clinics, practitioners, and pharmacies. FOF sales to private firms comprised about 30 percent of the total A.I.D.-furnished contraceptives distributed in Egypt, and were governed by a revenue agreement with USAID/Egypt. The public channel sold the remaining 70 percent through EPTC without a revenue agreement.

Under the Control of Diarrheal Diseases activity, Project 263-0137, USAID/Egypt buys foil packets of salts manufactured from imported raw materials by a public sector

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1/ The rate of exchange in effect during this period ranged from LE.83 to LE1.35 = $1.00. We estimated that the average rate in effect for purposes of the audit was LE1.00 = $1.00.

company, Chemical Industries Development (CID). Oral rehydration therapy has been credited with reducing mortalities in young children from dehydration associated with diarrheal diseases, through increased availability and use of rehydration services and materials. About 60 percent of the salts are sold to pharmacies through two distributors: EPTC and Middle East Chemicals. The remaining 40 percent is distributed free to GOE-operated health units, hospitals, and clinics as a public service.

Costs incurred by USAID/Egypt projects to purchase A.I.D.-financed commodities for resale through the public sector totaled an estimated $8.2 million under the Population projects and $3.2 million under the Control of Diarrheal Diseases project since inception of these activities in September 1977 and September 1981, respectively.

B. Audit Objectives And Scope

The Regional Inspector General for Audit, Cairo (RIG/A/C) made an economy and efficiency audit of income generated from public sector sales of A.I.D.-financed commodities, during the period from July 1, 1983, through June 30, 1987. FOF private sector sales were not covered by this audit. The audit objectives were to determine whether: (1) implementing agencies were properly accounting for and controlling income from sales of A.I.D.-financed commodities; (2) project revenues were being used efficiently; and (3) controls were adequate to ensure that price, source, and origin requirements were enforced. No previous audits were made that focused on project income.

The audit reviewed the public sector sales of A.I.D.-financed commodities under the Population-Family Planning II Project (263-0144) and the Control of Diarrheal Diseases Project (263-0137). The audit included visits to USAID/Egypt project offices and to public sector offices, including the Ministry of Health, project implementing agencies, EPTC, companies involved in the manufacture and importation of ingredients for oral rehydration salts and, at the local level, to two Maternal Child Health centers in two governorates. The auditors also visited the offices of Family of the Future in the private sector to review comparable procedures. At locations visited, discussions were held with officials involved, records were reviewed, and procedures were tested on a judgemental basis. The review of internal controls and compliance was limited to the findings in this report.

The tests of company accounting records were limited to the extent that authorities permitted the auditors to access certain information and records. For the Control of Diarrheal Project, the auditors were not allowed to access the records of Chemical Industries Development (CID), the manufacturer of oral rehydration salts, or of El Goumhoriah, the importer for CID raw materials. In these cases, the testing was limited to discussions with GOE officials and to reviews of invoices and reports sent to the implementing agency.

For the Population project, the auditors could not review source documents and accounting records at EPTC for amounts collected by them from pharmacies. However, other information and records were provided by EPTC, as requested. Limitations or restrictions on access to records by the GOE prevented the auditors from reaching some conclusions as to the proper accounting and control of project income. For example, the auditors were unable to determine the total amount of collections that were withheld by EPTC or the purposes for which these funds were used. In the case of CID and El Goumhoriah, the auditors were unable to determine if the records supported that A.I.D. price, source, and origin requirements were being met for locally manufactured salts using imported components. These issues were considered in the recommendations and suggestions of this report.

The audit work was done between March 1987 and February 1988 and was carried out in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The audit showed that there were material management control weaknesses over project income on the part of USAID/Egypt and the GOE implementing agencies. USAID/Egypt had not established effective systems for overseeing public sector cost recovery activities. The GOE implementing offices had not properly accounted for, controlled, and used proceeds from sales of A.I.D.-financed commodities for the two USAID/Egypt projects examined. A.I.D. guidelines for generation and use of project income were not followed, and adequate controls had not been established to ensure that price, source, and origin requirements were enforced in the procurement of locally produced oral rehydration salts.

Some cost recovery practices were introduced into the projects. In the public sector programs, the implementing offices had established accounting records and appropriately accounted for certain proceeds. Nevertheless, significant problems existed in these systems, and USAID/Egypt did not know whether the proceeds were put to productive use as expected.

NPC did not segregate the proceeds from sales of A.I.D.-financed and non-A.I.D.-financed contraceptives; use proceeds for mutually agreed upon project purposes; and detect a shortfall equivalent of more than $701,000 in Egyptian pounds that should have been turned in to NPC by its distributor.

Since 1984, the National Control of Diarrheal Diseases Project (NCDDP) had accumulated $2.2 million in equivalent project income in a non-interest-bearing commercial account, but had not used these funds. At the same time, USAID/Egypt continued to advance funds to NCDDP to pay project costs. Moreover, USAID/Egypt purchases of locally procured salts included $261,518 in costs that could have been avoided had NCDDP acquired foreign exchange at official rates. Finally, NCDDP lacked controls to ensure that A.I.D. price, source, and origin requirements were met.

The report recommends that USAID/Egypt enter into revenue agreements with the GOE for the projects, define project income, segregate gross revenues, establish special accounts, obtain interest on deposited funds, provide accounting and budgetary controls, reach mutual agreement on use of funds, establish adequate reporting systems on collections and uses of project income, and reduce A.I.D. advances. During the audit USAID/Egypt project officials initiated revenue agreement actions with the Ministry of Health covering some of the issues, but much more needed to be done.

The report also recommends that USAID/Egypt facilitate an agreement between GCE entities on collections of sales revenues, and oversee these collections for the Population Planning projects; advocate the highest official rate of foreign exchange costs for all A.I.D.-funded transactions; establish systems to monitor the sufficiency and accuracy of reporting line-item costs; and determine the reasonableness of prices for oral rehydration salts based on cost analysis for the Diarrheal Diseases project. USAID/Egypt began to take corrective action on these matters.

A. Findings And Recommendations

1. Population Project Income Was Not Properly Segregated And Used

The proceeds from public sector sales of A.I.D.-financed and non-A.I.D.-financed contraceptives, totaling more than LE2 million ($2 million), were not segregated and used for mutually agreed upon project purposes. A.I.D. internal control and financial management guidelines emphasize the need for proper fund accountability and agreements regarding the use of project funds. The primary cause of these conditions was that although cost recovery was an explicit feature of the private sector population planning subproject, there were no revenue provisions in the project agreements for the public sector projects. Project designers did not define project income, require that gross project income be segregated and deposited in a special account, or provide for accounting and reporting controls over the collection and use of these funds. As a result, USAID/Egypt was not assured that the $1.38 million equivalent revenues turned in by the distributor to the GOE implementing agency included all revenues collected from sales of A.I.D.-financed contraceptive commodities, and that the health benefit impacts realizable through the reflows of A.I.D.-financed commodities were being achieved.

Recommendation No. 1

We recommend that USAID/Egypt enter into a revenue agreement with the Government of Egypt regarding project income generated from public sector sales of contraceptives under USAID/Egypt Project No. 263-0144: Population-Family Planning II. The agreement should, at a minimum: (a) define project income to include gross sales revenue from A.I.D.-financed contraceptives and, if agreed to, non-A.I.D.-financed sales revenue; (b) require that gross revenues be segregated and collected in a single interest-bearing bank account (special account), (c) provide for accounting and budgetary controls and mutually agreed upon use of the gross revenues; and (d) establish a reporting system so that USAID/Egypt is promptly notified of gross revenues collected and amounts disbursed.

Discussion

The concept of depositing funds from sales of A.I.D.-financed commodities into special accounts is set forth in the Foreign Assistance Act of 1971, Section 609, and is stated in the Bilateral Assistance Agreement with the Government of Egypt. A.I.D. guidelines for the retention and use of project income are found in A.I.D. Handbook 13, paragraph IJ-1. Establishing segregated special accounts help achieve a basic internal control objective of properly accounting for the receipt and disbursement of funds.

Under USAID/Egypt Project No. 263-0144: Population-Family Planning II, EPTC, the public sector distributor, did not segregate sales proceeds of A.I.D.-financed contraceptives from those of non-A.I.D.-financed contraceptives. EPTC collected proceeds totaling more than $2 million from: (1) sales of contraceptives made through GOE-operated and other independent units; and (2) sales made by EPTC to private sector pharmacies. The A.I.D.-financed contraceptives that were sold included: condoms, IUDs and vaginal foaming tablets. Non-A.I.D.-financed contraceptives included locally produced oral contraceptives provided by the Ministry of Health.

EPTC also was responsible for receiving and storing the contraceptives in its central warehouse and in about 90 intermediate and branch warehouses throughout Egypt from which commodities were distributed. In regular practice, EPTC collected gross revenues through deposits made by GOE family planning units and from sales to private pharmacies. EPTC consolidated the monthly receipts and turned them in by check to the NPC. (After July 1, 1987, EPTC sent collections directly to the MOH and other GOE organizations).

From July 1, 1983, through June 30, 1987, the period covered by the audit, EPTC reported collections to NPC totaling LE1.38 million ($1.38 million), of which LE929,000 was remitted from the sales of GOE family planning units and LE451,000 from sales to private pharmacies. The collections represented sales of both A.I.D.- and non-A.I.D.-financed contraceptives.

USAID/Egypt did not oversee the collection or use of these funds, although clearly it had an interest in how the funds were to be used. For example, USAID/Egypt did not: (1) establish a revenue agreement with the GOE; (2) receive reports of the amounts collected or disbursed; (3) participate in establishing accounting and budgetary controls; or (4) formally approve the purposes for which the funds were spent.

NPC gave different treatment to the sales revenues remitted to it. Pharmacy collections were transferred to the GOE National Treasury, whereas GOE health and family planning unit collections were transferred to the MOH for use as salary supplements in accordance with Ministerial Degree No. 116. According to USAID/Egypt project officials, USAID/Egypt was aware of the Decree and of the salary supplement use of the revenues; however, no formal agreement was executed on these matters.

Neither the project paper nor the grant agreement established cost recovery objectives for the collection of sales revenues from the public sector (EPTC) distribution. By contrast, a revenue agreement between USAID/Egypt and the Family of the Future (FOF) provided for the collection and disposition of FOF sales monies through the private sector distribution channel. USAID/Egypt and FOF formally agreed that the FOF should use the revenues for operational and program expenditures consistent with family planning project objectives.

In addition, project designers did not define what constituted project income from the public sector distribution. A.I.D. regulations and the Bilateral Agreement are clear that gross income from A.I.D.-supported activities must be deposited in special accounts and controlled for mutually agreed upon purposes. The guidance is not clear in the case of funds collected from sales of GOE-financed products. In our opinion, because the project is a joint U.S.-GOE-supported endeavor, these sales should be considered project income as well in order to simplify the collection and reporting processes. Agreement with the GOE should be reached on the definition of project income, including the treatment of non-A.I.D.-financed proceeds that are commingled, in formulating a revenue agreement to guide project activities in achieving the health benefits contemplated.

Management Comments

During the audit, the USAID/Egypt Project Office executed PIL No. 15 authorizing a systems development subproject, effective July 1, 1987, which incorporated a proposed revenue agreement to be implemented by the public sector after signing. The agreement covers the revenue generated from the sales of contraceptive commodities donated by A.I.D. to the MOH. The agreement does not cover income from: (1) sales of non-A.I.D.-financed contraceptives; (2) sales of non-MOH sponsored family planning units; or (3) sales to pharmacies. Project officials plan to cover the latter by other agreements to be formulated. USAID/Egypt action, therefore, has been responsive only in part to Recommendation No. 1.

In its later comments, USAID/Egypt did not take serious issue with Recommendation No. 1 and indicated it was negotiating a new revenue agreement with the MOH and EPTC that is responsive to Recommendation No. 1.

Office Of Inspector General Comments

Recommendation No. 1 can be closed upon issuance of the new revenue agreement incorporating the elements mentioned in the recommendation.

2. Population Project Income Was Not Remitted To The Implementing Agency To Achieve Further Health Benefits

At least LE701,000 ($701,000) from public sector sales of family planning devices was not remitted to the cognizant GOE office by the distributor, EPTC, who kept the funds and used them in its commercial operations. The $701,000 represented revenues for the period, July 1, 1983, through June 30, 1987, for two of the three major A.I.D.-financed contraceptives. The total unremitted amounts were not disclosed by the audit and could be considerably higher.

Notwithstanding A.I.D. requirements for prudent oversight and utilization of project resources, no written agreement on sales revenues existed between EPTC and the implementing office, NPC. Both NPC and USAID/Egypt project officials understood that the sales revenues would be remitted to NPC and used to achieve family planning objectives. EPTC claimed it had an oral agreement with the NPC to keep the revenues to defray distribution costs. The NPC disputed this contention. In any event, neither the Mission nor the GOE agency had systems in place to reconcile the amounts turned in by EPTC with actual collections.

USAID/Egypt, therefore, did not know the extent to which the $701,000 was being used to achieve further population planning objectives or, instead, used improperly in the distributor's operations.

Recommendation No. 2

We recommend that USAID/Egypt facilitate a written agreement between the Egyptian Pharmaceutical Trading Company and the Ministry of Health, whereby gross revenues from sales of A.I.D.-financed contraceptives are accounted for and remitted to the Ministry of Health and used for mutually agreed upon project related objectives.

Recommendation No. 3

We recommend that USAID/Egypt set up a system for comparing project income collected with the sales value of issues from Government of Egypt warehouses in order to effectively manage project resources.

Discussion

A.I.D. Handbook 3, sets forth requirements for managing project resources: "In the case of A.I.D.-financed bilateral projects, which are mutually developed and agreed upon by A.I.D. and the cooperating country, primary responsibility for overall management ... rests with the country agency or entity concerned...Notwithstanding this concept, however, A.I.D. continues to be responsible for prudent oversight and utilization of the A.I.D. resources invested in such projects."

During the period July 1, 1983, through June 30, 1987, EPTC reported collections from pharmacy sales of LE451,000 ($451,000) to NPC. According to EPTC's financial manager, EPTC deposited all other funds collected from pharmacies into its own account and did not report these collections to NPC. Neither NPC nor USAID/Egypt officials were aware of any agreement that permitted EPTC to retain these funds. These officials understood that the sales revenues would be remitted to NPC and used to achieve family planning objectives.

A shortfall in the proceeds remitted to the NPC was indicated when the auditors compared revenues to quantities distributed from EPTC warehouses. The audit showed that the total collections reported of $451,000 were less than the sales value of $701,000 for two major A.I.D.-financed contraceptives: condoms and Copper T intrauterine devices, that EPTC had distributed to pharmacies during the period July 1, 1983, through June 30, 1987. A third major item, vaginal tablets, and other A.I.D.-financed items were not tested.

This apparent shortfall in remittances was discussed with EPTC's Financial Manager. The official told the auditors that EPTC did not report any collections to NPC for sales to pharmacies of contraceptives financed by A.I.D.. The official said that EPTC had retained these collections to compensate EPTC for profit, storage fees, and employee incentives and also for distributing contraceptives to GOE-operated family planning units without charge.

The gross revenues withheld by EPTC from the two contraceptives tested were calculated based on sales value (LE1.00 = $1.00) of warehouse issues, as follows:

		Value
Condoms	- 490,228 boxes of 100 at LE1.155 per box	$566,213
Copper T's	- 192,882 each at LE.70 per unit	135,017
		$701,230

The EPTC official also said that gross pharmacy collections from A.I.D.-financed contraceptives had been withheld from NPC since the beginning of the project. The only pharmacy revenues remitted to NPC were for locally manufactured oral contraceptive pills which EPTC had turned in net of service fees ranging from 1/2 to 1 piaster per unit (7.2 percent to 14.3 percent) of these collections. Although Project No. 263-0144 had called for the GOE to contribute locally produced contraceptives to the project, these revenues were not transferred to the MOH for use in the project. Instead, NPC deposited the LE451,000 in the Central Bank of Egypt to the account of the Ministry of Finance - National Population Council Revenue Account for the National Treasury.

NPC's lack of internal control in the overall management of project income was the primary cause of not detecting the shortfall in EPTC collections. Monthly computerized reporting of EPTC warehouse distributions had been available since 1984 or earlier, but NPC had not compared pharmacy sales to warehouse stock issues or received any documentation independent of EPTC to verify the amounts collected. USAID/Egypt project officials, also, had not given adequate attention to project income generated from A.I.D. resources and the GOE did not report collections to USAID/Egypt.

The inability of NPC and USAID/Egypt project officials to prudently oversee the collection and disposition of project income resulted in funds being used for operating costs of the distributor without proper accountability to the project, instead of for achieving designated health benefits contemplated by the project. An agreement on the treatment of revenues would help ensure these benefits were achieved.

Management Comments

USAID/Egypt generally agreed with Recommendation Nos. 2 and 3, and was negotiating a new revenue agreement with the MOH and EPTC. USAID/Egypt said that the report did not give it any credit for having created an effective nationwide system of contraceptive distribution through EPTC, and for largely exceeding the goal of establishing and strengthening distributor operations. USAID/Egypt said it recognizes the problem of not having an explicit revenue agreement with EPTC, but that EPTC's use of these funds did not necessarily indicate impropriety. USAID/Egypt said that it would negotiate support for EPTC operations as a part of the new agreement.

Office Of Inspector General Comments

Recommendation No. 2 will be closed upon issuance of the new revenue agreement that incorporates the elements set forth in the recommendation. Recommendation No. 3 will be closed upon evidence that a monitoring system is in place that ensures project income is properly collected. Regarding the comments that the report does not give credit to USAID/Egypt's efforts in establishing a distribution system, the audit was not directed to determining whether the distribution system functioned efficiently or effectively. EPTC's use of the funds, in our view, was improper because there was no specific agreement that the funds should be retained by the distributor. Moreover, the retention was not known by USAID/Egypt and NPC officials until it was disclosed by the audit.

3. Diarrheal Diseases Project Income Was Unused And Accumulating

LE2.2 million (about $2.2 million) generated by National Control of Diarrheal Diseases Project (NCDDP) from sales of A.I.D.-financed oral rehydration salts between 1984 and 1987 was unused and accumulating in a GOE non-interest-bearing commercial bank account, without agreement as to how the funds would be used. USAID/Egypt and NCDDP officials intended that the income be used to further public health services, but had not agreed on the specific uses for the funds and had not used them. At the same time the project income was being accumulated, the project was being funded by A.I.D. cash advances to defray project operating expenses. As a result of not using the funds, the project's health benefit objectives were not maximized and the Mission made unnecessary advances.

Recommendation No. 4

We recommend that USAID/Egypt implement arrangements with the Government of Egypt to: (a) spend project income for mutually intended purposes; and (b) establish a budgeting, accounting, and reporting system to control the use of such funds.

Recommendation No. 5

We recommend that USAID/Egypt enter into an agreement with the Ministry of Health to: (a) transfer the special account to an interest-bearing bank account, so that idle funds will draw interest until used; and (b) change the present method of financing the project from A.I.D. advances to A.I.D. direct reimbursements at least until idle funds are reduced to a minimal acceptable level.

Discussion

A.I.D. Handbook 13, Chapterl, paragraph 1J sets forth guidelines for using gross income from A.I.D.-supported activities, including the sale of commodities. Such income "... earned during the project period shall be retained by the recipient and, in accordance with the grant or agreement, shall be:

"a. Added to funds committed to the project by A.I.D. and the recipient and be used to further eligible program objectives;

"b. Used to finance the non-A.I.D. share of the project when approved by A.I.D.; or

"c. Deducted from the total project costs in determining the net costs on which the A.I.D. share of costs will be based."

A 1978 Egyptian Presidential Decree allows the U.S. Government to use the income generated from goods or services sold to fulfill local currency program requirements. When the grant terminates, the GOE may withdraw and use the funds remaining for its own purposes.

The NCDDP generated income from sales of A.I.D.-financed oral rehydration salts under its project agreement with the Mission. Sales of the salts approximated LE2.498 million during the period February 1, 1984, to June 30, 1987. By October 31, 1987, after deducting commissions of LE296,000 ($296,000) for quantities distributed and sold, the NCDDP accounted for and deposited funds, totaling LE2.202 million (about $2.2 million), into a commercial bank account.

The proceeds were to be jointly programmed by USAID/Egypt and the MOH to achieve further public health benefits. These funds, however, merely accumulated in the Misr Bank, El-Dawaween branch in Cairo, in a non-interest-bearing commercial account. The idle funds lost about $1 million in purchasing power due to restructuring of the official exchange rate and to the inflation rate in Egypt over the last 3 years. Further, during the same period when proceeds were being accumulated, the project received monthly USAID/Egypt advances to finance local currency expenditures. On July 20, 1987, the project had outstanding advances totaling $848,000.

NCDDP was not using the accumulated funds for project purposes and the funds were not drawing interest. By contrast, project income accumulated by the FOF under a subproject of Population-Family Planning Project II (No. 263-0144), was deposited in an interest-bearing account at 5 percent in a sister branch of the Misr Bank. The FOF revenue account funds were "loaned" in increments to the FOF checking account and used, as needed, to fund project costs until reimbursed by USAID/Egypt.

By July 1987, USAID/Egypt had made some unsuccessful attempts with NCDDP to use the funds that had accumulated for more than 3 years. According to a USAID/Egypt letter dated November 26, 1984, the NCDDP was required to program these funds and the Mission had to agree on their use. Sales income from 1984 was to be used to finance the cost of foil for packaging the salts. Instead, the salts producer took over the procurement of foil as a cost of production. Between March 1985 and September 1986 the NCDDP had three executive directors. Because of this, USAID/Egypt apparently was unable to get NCDDP to focus on the issue of the accumulated funds and the agreement was cancelled in July 1986 without spending any of the project income.

The RIG/A/C first reported the unused funds in a November 25, 1986, memorandum to USAID/Egypt project officials. The RIG/A/C informally recommended that USAID/Egypt enter into a revenue agreement with the MOH, the Ministry of Economy and Planning, and the NCDDP, setting forth a budget and time plan for using project income, including uses for working capital. The accumulated unused funds of LE2.202 million through October 31, 1987, were equivalent to an estimated $2.056 million at official foreign exchange rates ranging from LE.83 to LE2.17 for $1.00.

Management Comments

During the audit, USAID/Egypt advised us that it had taken action to begin using the accumulated project income. On July 29, 1987, USAID/Egypt entered into Grant Agreement No. 1 with the MOH extending the project for an additional 3-year period. Included in the extension was the stipulation that proceeds from salt sales deposited in the Special Account would be used to pay project-related costs. The decision to use the LE2.202 million special account funds to finance the non-A.I.D. share of the project before the grant ends added over $1 million to the project funding at the existing foreign exchange rate (LE2.20 = $1.00).

Controls for budgeting, accounting, and reporting also were established. USAID/Egypt issued PIL 20, as amended on November 16, 1987, approving a line-item budget for NCDDP to expend LE1.07 million of the accumulated balance during the first year (October 1987 through September 1988) of the Grant extension. PIL 20 approved the use of the funds for incentives, equipment, supplies, local training and other local costs, with the understanding that the funds be considered part of the GOE cash contributions to the project. The project started to spend special account funds during the last quarter of calendar year 1987, in the amount of LE17,429 ($7,922) for incentives.

USAID/Egypt and the NCDDP also reviewed the project funding requirements and agreed that ORS salts production and distribution costs can be paid from the Special Account. It said that the 1988 contract would be negotiated and executed to comply with GOE procurement rules and regulations. USAID/Egypt will also advise the NCDDP to move the Special Account funds to an interest-bearing account if allowed under GOE regulations.

Office Of Inspector General Comments

USAID/Egypt actions and comments are positive and responsive. Based on actions taken we consider Recommendation No. 4 to be resolved upon issuance of this audit report. Regarding Recommendation No. 5, we concur in the use of Special Account funds, instead of A.I.D. funds, to pay for future salts contracts. Funding in this manner should save an estimated $720,000 of A.I.D. financing, based on the previous contract levels, that can be deobligated or reprogrammed for other project purposes. However, the Mission should clarify with its Legal Counsel the extent to which A.I.D. procurement regulations must be applied when Special Account funds are used for contract purposes. Recommendation No. 5 can be closed upon evidence that the proposed actions are implemented.

4. Unnecessary Foreign Exchange Costs Were Incurred In The Diarrheal Diseases Project

USAID/Egypt paid $261,578 in excess of official exchange rates for commodities imported for production of oral rehydration salts. These payments for 1984 and 1985 arose from the importer converting Egyptian pounds at rates lower than official rates. These costs were passed on to USAID/Egypt as part of the salt's production and distribution costs. Foreign exchange costs for 1986 and 1987 were still to be computed which can further increase the Mission's payments in this matter.

The Project Agreement provided that USAID/Egypt was entitled to the highest rate of exchange prevailing and declared by the Government of Egypt. The GOE was to provide the foreign exchange necessary to ensure timely importation of commodities. Without proper Mission clearance, however, USAID/Egypt officials approved host country contracts between the GOE implementing agency and the salt's manufacturer that contained terms which conflicted with the Project Agreement. These contracts stipulated that the implementing agency would reimburse the manufacturer for the differences between the official and actual rates paid for foreign currency to import the raw materials. These higher than necessary costs then were passed on to the project and financed by USAID/Egypt.

As a result, project resources intended to improve the health of needy Egyptians went instead to compensate for the costs of obtaining foreign exchange which the Government of Egypt should have made available.

Recommendation No. 6

We recommend that USAID/Egypt: (a) have the National Control of Diarrheal Diseases Project disclose line-item costs in sufficient detail to allow proper USAID/Egypt review and approval of allowable costs; and (b) before approving the oral rehydration salt's supply contract for 1987 and 1988, ensure that the contract is properly cleared by USAID/Egypt officials, including the Mission Director, in accordance with Mission Order 5-4.

Recommendation No. 7

We recommend that USAID/Egypt pursue arrangements with the Government of Egypt so that the commodity importer for the oral rehydration salt procurements is provided the foreign exchange necessary for the A.I.D.-funded transactions.

Discussion

The Diarrheal Diseases project grant agreement, dated September 27, 1981 (as amended July 29, 1987), called for USAID/Egypt to purchase local currency needed for the project with dollars at the highest rate of exchange prevailing and declared for foreign exchange by the GOE (Arab Republic of Egypt). USAID/Egypt purchased Egyptian pounds with U.S. dollars at prescribed official rates and advanced the Egyptian pounds to NCDDP in increments to finance project costs. The A.I.D.-financed local currency was used by NCDDP, in part, to pay CID, a local drug manufacturer, for the production and distribution of oral rehydration salts at a contracted price of 36 piasters (LE.36) per box.

Article 13 of the production contract between NCDDP and CID provided that NCDDP would reimburse CID for differences between the official rate and the actual rates paid for foreign currency to import the raw materials. During 1984 and 1985 the official rate (LE.83 = $1.00) was higher than the rates reportedly obtained by the importer from the Central Bank of Egypt in its conversions for other foreign currencies. For example, in 1985 the official rate was 65 percent to 99 percent higher than the reported rates that El Goumhoriah Drug Company, the importer, obtained for comparable foreign exchange in British sterling, Dutch florin, and Japanese yen, to import CID's raw materials. In other words, the importer had to exchange more pounds than prescribed at the official rate in order to obtain the foreign currency to pay its suppliers.

For fiscal years 1984 and 1985, CID invoiced NCDDP a total of LE217,110 for foreign exchange differences. According to NCDDP officials, CID had not yet passed on foreign exchange differences for 1986 and 1987. NCDDP reimbursed CID for the LE217,110 from the pounds advanced by USAID/Egypt at a cost of $261,578. Although USAID/Egypt's intent was to underwrite the costs of salts, the LE217,110 amounted to unncecessary payments to the importer.

The project agreement, Section 4.4, required the GOE to provide the producer of the salts with the foreign exchange allocations necessary to ensure timely importation of commodities. The host government should have provided the foreign exchange to the importer at the same rate that USAID/Egypt paid for the local currency, since this rate was designated by the GOE as the highest rate prevailing. GOE allocations were not required the first year of the project, according to the prior USAID/Egypt project officer, because there was no CID contract. In subsequent years, this aspect apparently was overlooked.

An alternative open to USAID/Egypt was to provide U.S. dollars for the procurement. A request from the Ministry of Health, dated March 21, 1985, to provide CID with U.S. dollars, was turned down by USAID/Egypt because using dollars raised a number of problems including A.I.D. rules covering source, origin, competition, and shipment on U.S. flag carriers. USAID/Egypt officials rationalized that making dollars available for the 1985 procurement substantially complicated matters and would prove quite time consuming. Complications aside, there was no evidence that USAID/Egypt adequately considered the cost aspects in its rationalization. Had NCDDP obtained A.I.D.-financed dollars, instead of local currency from A.I.D. to finance the importation of raw materials, the unnecessary costs could have been avoided.

In response to the issue raised by the audit, the USAID/Egypt project office, in February 1988, advised the NCDDP that, under the Grant, the GOE was responsible for the provision of foreign exchange for the purchase of commodities to support the production of salts, and that A.I.D. would no longer fund foreign exchange rate differences.

Approvals of Supply Contracts

As indicated earlier, the problem of A.I.D.'s paying excess foreign exchange costs stemmed, in part, from the Mission's approval of the GOE's supply contract. The USAID/Egypt Associate Director responsible for the project approved the 1984 salt's supply contract. An acting Associate Director approved the calendar year 1985 amendment (approved May 12, 1985) and the 1986 contract (approved February 26, 1986). The 1987 contract had yet to be received or approved by USAID/Egypt. None of the contracts were formally cleared by a noncompetitive review board or approved by the Mission Director, as required by Mission Order 5-4, for procurements that are not pursuant to competitive procedures.

Although Associate Directors may normally approve host country contracts up to $5 million, Mission Order 5-4, paragraph 37, dated January 31, 1985, requires that the host country contracts for procurements not pursuant to competitive procedures further be cleared by a Non-Competitive Review Board consisting of the Contracting Officer, the Senior Legal Advisor and a senior project officer from an office not responsible for the procurement. 1/ Noncompetitive contracts for commodity procurements above $25,000 must be approved by the Mission Director.

Disclosure of Foreign Exchange and Other Costs

The Diarrheal Diseases project has a line-item budget. USAID/Egypt defines and approves this budget by use of Project Implementation Letters (PIL). The line-item caption ORS Production and Distribution under the Grant, provided A.I.D. financing for production and distribution of packaged oral rehydration salts to be undertaken by a local drug manufacturer. PILs Nos. 12 and 16 further defined and gave A.I.D. approval for the line-item budget.

Under the present system, A.I.D. advanced funds to NCDDP and later received cost reporting by budget line item. However, USAID/Egypt project officials did not receive enough information to properly monitor costs. USAID/Egypt project officials did not know, for example, that LE217,110 of foreign exchange costs had been charged to the line item, ORS Production and Distribution. Current USAID/Egypt project officials stated that they were aware of the contract provision allowing the differential to be paid, but were unaware that these costs had been added to the salt's production and distribution line-item costs.

Also, NCDDP charged other costs to this line item category that were not specifically mentioned in the PILs, including salary supplements, printing, and cups and spoons. These costs, including the differential on foreign exchange, totaled LE987,000 (about $987,000), or about 33 percent of the A.I.D.-financed production and distribution line-item costs of LE3.009 million ($3 million). Such charges resulted in the reported costs of salts being distorted and limited USAID/Egypt's ability to manage the project. For example,

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1/ Mission Order 5-4, amended March 21, 1988, redefined the USAID/Egypt Non-Competitive Review Board to consist of: the Associate Director/Legal, the Office Director/Contract Services, and the Office Director/Project Support.

had USAID/Egypt been properly advised of the foreign exchange charges for 1984, USAID/Egypt could have avoided these costs in subsequent years by ensuring that the GOE provided the required foreign exchange allocations.

USAID/Egypt has authority to invoke changes in cost reporting requirements for the Grantee; Section 7.2 of the Grant sets forth that:

> "...the Grantee may obtain disbursements of funds...required...by submitting to A.I.D., with necessary supporting documentation as prescribed in Project Implementation Letters, requests to finance such costs."

USAID/Egypt should improve its monitoring of costs for this project and review the charges to the ORS Production and Distribution line item in order to ensure the integrity of project costs billed to the Mission.

Management Comments

USAID/Egypt said that steps will be taken to more closely review expenditures made to the line item for ORS production costs; that agreement was reached with the NCDDP not to use A.I.D. funds for the CID contract (see Appendix 2), but instead, to budget project income funds for this purpose; and that the NCDDP had been advised to provide foreign exchange for future local salt procurements from GOE funds, in accordance with the Grant Agreement.

Office Of Inspector General Comments

USAID/Egypt's proposed actions are positive and responsive to the intent of Recommendation Nos. 6 and 7. Recommendation No. 6 (a) will be closed upon evidence that a system is in place to ensure adequate detail reporting of costs by NCDDP. The system should cover measures for both A.I.D.-financed costs and project-income-funded costs. Recommendation No. 6 (b) will be closed when there is adequate evidence to assure that the Mission procurement policies are followed. Recommendation No. 7 is closed upon issuance of this audit report on the basis of the actions taken.

5. Cost Analysis Needed To Assure Reasonableness Of Oral Rehydration Salt's Price

USAID/Egypt purchased $3.2 million of oral rehydration salts from a monopoly parastatal supplier in Egypt without benefit of a cost analysis to support the price. Mission procurement regulations require such an analysis. These purchases began in 1984 and continued through 1987 at a price fixed by the Government's Pharmaceutical Board. The manufacturer would not make its records available to us to review costs, and claimed to be losing money on the arrangement. The purchase price, however, included such questionable costs as excessive foreign exchange costs and possible customs duties. Distribution costs further increased the total cost of the salts to A.I.D. As a result of the lack of justification for the proposed costs, USAID/Egypt had limited assurance of the reasonableness of the prices paid for the salts and their distribution.

Recommendation No. 8

We recommend that USAID/Egypt establish the reasonablness of the price for oral rehydration salts in accordance with Mission procurement regulations and the terms of the project paper which call for in-depth analysis of the supplier's production costs and pricing policies, before approving the 1987-88 supply contract.

Discussion

A.I.D. Handbook 1 Supplement B, Chapter 18, A, 1.C states that "...In order to support the recommendation for local cost financing for a project, the Mission Director is required to make a determination, based upon a reasonable analysis of the supply and prices of indigenous and shelf item goods and services expected to be required, that such prices are reasonable, taking into account comparable delivery terms and prices from eligible sources, and the implementation schedule of the project."

A.I.D. Handbook 11 describes host country contracting procedures and requires that in cases where competitive award fails, all contracts for $100,000 or more submitted for USAID approval, should be accompanied by a record of negotiations, including the reasons for finding that the offer is most advantageous to the Contracting Agency, price and other factors considered. This has been interpreted by

A.I.D. contracting officers to include an analysis of costs in sufficient detail to ensure that the negotiated price is reasonable. 1/

Consistent with the thrust of these requirements, the project papers called for an in-depth analysis to be made of CID's production costs and pricing policies to serve as a basis of a contract with CID or other Egyptian pharmaceutical firms, if required. Nevertheless, USAID/Egypt awarded the contracts for oral rehydration salts for 1984, 1985, and 1986 without requiring a formal submission of the contractor's proposed independent analysis of the price. A consultant (Westinghouse Health Systems), who was to analyze production costs in 1982, reported that details were not available. As a result, the consultant's calculations were only tentative, based on data supplied by UNICEF, the World Health Organization, and several U.S. pharmaceutical companies.

From 1984 through 1987, USAID/Egypt purchased $3.2 million of oral rehydration salts, noncompetitively, from CID, a local public sector supplier, without obtaining a cost analysis. CID informed the auditors that it loses money producing the salts, but the supplier did not allow the auditors access to CID's costs of production records. As a result, the auditors were unable to review the reasonableness of CID's costs and price factors. USAID/Egypt's project files indicated that there were some comparisons of prices on a worldwide basis, but evidence of the real costs of manufacture in Egypt were lacking.

Other evidence indicated that the reasonableness of the price paid to CID under the agreement was questionable. In 1984, for example, the contract price of 36 piasters was 6 piasters (20 percent) higher than the price at which CID was selling a similar product. Also, according to Mission records, competitive bids for the 1985-87 supply strategy had failed because of insufficient bidder responses with only

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1/ A.I.D. Handbook 11, Chapter 4, further states that:

> "Cost analysis is an essential tool to the contract negotiator in the conduct of sound and meaningful negotiations. It provides the negotiator with a means of evaluating the contractor's proposal and its relationship to the Contracting Agency's estimate..."

one company, El Khahira, indicating its intention to submit a bid or proposal.

El Khahira, a private company, proposed to produce a limited quantity of the salts without any special foreign exchange assistance from the project. El Khahira's proposed price per packet was also about 17 percent lower (LE.30) than the CID contract price of LE.36, or 25 percent lower than the CID contract price of LE.40 including the foreign exchange differential of LE.04 for 1985. Distribution costs were not factored into the contract price. In the normal course of business events, CID pays for the cost of distributing its various products. In the case of the salts, however, NCDDP paid the fixed price of LE.36 (the price that would have been paid by the outlets) plus an additional 12-percent distribution fee to alternative distribution channels.

There also was reason to believe some CID costs were excessive for USAID/Egypt financing. For example, according to the importer, El Goumhoriah, customs duties and related costs were added to CID's costs of imported components. Such costs, if passed to A.I.D., run contrary to Section B.4 of the A.I.D. standard provisions annexed to project agreements, which provide, in part, that "...the Grant will be free from any taxation or fees imposed under laws in effect in the territory of the Grantee." The matter of questionable excessive foreign exchange costs was discussed previously under Finding 4, page 18.

USAID/Egypt procurement regulations required that when a locally manufactured item was purchased on a noncompetitive basis, an analysis must be made of the reasonableness of the price and that appropriate Mission clearances be obtained. In addition, the project papers called for an in-depth analysis of production costs and pricing to serve as a basis for oral rehydration salt's supply contracts. USAID/Egypt project officials said the reasonableness was assured based on a comparison with the price of salts in the United States, the price the United Nations was paying in Egypt, and the price in other countries. These comparative prices, while informative, did not provide an adequate basis for establishing the price in Egypt contemplated by the project paper, because as a result of accepting the manufacturer's price without cost analysis, USAID/Egypt had limited assurance of the reasonableness of the prices paid for oral rehydration salts and their distribution. The lack of assurance had ramifications in terms of the proper use of project funds, continued production by the manufacturer at the existing price, the propriety of using a single manufacturer to meet production needs and to establish price, and the long-term availability of salts to consumers at acceptable prices.

A detailed analysis of the contractor's submitted price for supply of salts would give USAID/Egypt assurance as to reasonableness of the price offered, identify costs of a questionable nature, and provide a better basis for determining continued availability of salt's production should the Mission discontinue its financing.

Management Comments

In March 1988, USAID/Egypt obtained a listing from CID showing the salt's unit costs for 1983 broken down by ingredients, packaging, salaries and administrative costs totaling LE.33; and a similar analysis of proposed costs for 1988 totaling LE1.00. This information was responsive, in part, to Recommendation No. 8. These documents should be verified and accompanied by a record of negotiations and explanations in accordance with A.I.D. procedures for approving the 1987-88 CID contracts under noncompetitive conditions as outlined in this report.

USAID/Egypt also said that the NCDDP will fund the 1988 CID contract with income from project funds and that A.I.D. no longer contemplates funding the procurement of salts. If future events require A.I.D. to do so, USAID/Egypt will insist that any contract put forth for approval be accompanied by appropriate documents and approvals as set forth in A.I.D. and Mission requirements.

Office Of Inspector General Comments

USAID/Egypt's actions meet the intent of Recommendation No. 8. The recommendation is considered resolved upon issuance of this audit report. It will be closed when it is clear that the 1988 production contract is awarded using project income and that USAID/Egypt will no longer directly fund procurement of oral rehydration salts.

B. Compliance And Internal Control

Compliance

In the areas audited, the following exceptions to compliance were noted. Project income was not retained and used in accordance with A.I.D. Handbook 13, Chapter 1, IJ. Appropriate A.I.D. approvals and clearances were not obtained in approving host country contracts involving procurements without competition in accordance with Mission Order 5-4, paragraph 37.

Internal Control

The audit disclosed material weakness in management controls. A special account had not been established for depositing segregated funds from sales of A.I.D.-financed commodities. USAID/Egypt had not established reporting and budgeting systems with NPC and NCDDP in order to be kept advised of gross revenues and disbursements of project income; NPC lacked adequate controls to independently verify collections so as to detect a significant shortfall in amounts turned in by EPTC; USAID/Egypt's voucher approval system did not provide for sufficient reporting from NCDDP to identify payments of foreign exchange and other questionable costs; and NCDDP procurement controls were not adequate for USAID/Egypt to know if A.I.D. source, origin, and price requirements were met.

The review of compliance and internal control was limited to the finding areas in this report.

C. Other Pertinent Matters

USAID/Egypt did not have measures in effect to ensure that A.I.D. source and origin requirements were met for NCDDP-purchased oral rehydration salts financed by A.I.D. under the Control of Diarrheal Diseases Project. Current USAID/Egypt project officials relied on NCDDP and earlier planners to have established controls but this was not verified. As a result, USAID/Egypt did not have necessary assurances that the locally purchased products were eligible for A.I.D. financing.

A.I.D. Handbook 1, Supplement B, Chapter 18, stipulates that any imported component from a non-Free-World country makes the indigenous commodity (or imported shelf item) ineligible for A.I.D. financing.

Although NCDDP incorporated A.I.D.'s standard provisions in the local supplier's contract, NCDDP did not require the supplier to certify as to the source and origin of A.I.D.-financed goods. NCDDP purchased ORS from CID, a local supplier, with the knowledge that the major ingredients were imported from non-U.S. sources. The contract between NCDDP and CID stipulated that CID was not to import the materials from certain designated countries. The supplier, however, did not certify invoices as to country or origin, thus exposing the project unnecessarily to the risk that some ORS might have been ineligible for A.I.D. financing.

The importer told the auditors that the source and origin of the raw material components were from the same countries as the foreign exchange used. For example, the importer said that it purchased sodium chloride in florin from Holland; potassium chloride in pounds sterling from Great Britain; and dextrose anhydrous in yen from Japan. However, the importer did not permit the auditor to review the inspection certificates or other supporting documentation to identify the source and origin of the imported ingredients.

In view of the lack of documentary evidence on the source and origin of the imported commodities, USAID/Egypt should: (a) obtain and examine the importer's inspection certificates (showing the source and origin of imported components) to ensure that imported components of oral rehydration salts and other products are from designated Free World countries and are eligible for A.I.D. financing; and (b) establish a system to obtain source and origin certificates on future invoices from indigenous suppliers.

AUDIT OF
INCOME GENERATING PROJECTS

PART III - APPENDICES

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

April 18, 1988

M E M O R A N D U M

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

FROM: James B. Brody, FM/Audit Liaison

SUBJECT: Mission Comments on draft Audit Report: Income Generating Projects

REF.: (a) Mantione/Ferri Memo Dated April 12, 1988
(b) Tiffany/Ferri Memo Dated April 6, 1988

Attached are the two subject memos which constitute the Mission's response to the subject draft report.

Att: a/s above

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

MEMORANDUM

DATE : April 6, 1988

TO : Mr. J. Ferri, RIG/A

THRU : Mr. William F. Gelabert, AD/HRDC WFG
Mr. James Brody, Audit Liaison Officer

FROM : Terrence Tiffany, HRDC/P

SUBJECT : HRDC/P Comments of Draft Audit of Income Generating Projects

The following comments are in addition to the written comments previously submitted by HRDC/P (enclosed) and discussed in a recent meeting with RIG/A personnel: 4/

General: The report gives no credit to USAID for having created an effective nationwide system of contraceptive distribution through EPTC.1/ Such has long been one of the most important goals of the USAID population effort. Instead, the report unfairly takes USAID to task in several places with statements that funds generated from contraceptive sales were not used to "further AID health objectives" (pii), and "not being put to productive use in the population and health area as expected" 2/ (p.6) and that "at least $701,000 - which should have been used to achieve further population planning objectives was instead used for the distributors operations" (p. 14). All of these statements ignore the fact that establishing and strengthening distributor operations was and is one of our goals in the population sector, and it has largely succeeded.1/ The problem is that there is no explicit revenue agreement between USAID and EPTC. However, though there is no agreement controlling the funds collected by EPTC from sales to pharmacies, this does not mean that the actual use of these funds by EPTC was improper, as implied in the report.2/ In fact, any revenue agreement we subsequently negotiate with EPTC will contain support for EPTC operations as part of the agreement, which we regard as a legitimate use of the funds and which furthers USAID's "health and population objectives."

The report is not always clear in the distinction between USAID and non-USAID contraceptives supplies managed by EPTC. 3/ Moreover, HRDC/P seriously doubts that the GOE will agree to include non-USAID supplied contraceptive fund generations in any revenue agreement. (p.13) By far the most commonly used contraceptive - the oral pill - is not now even supplied by USAID for use in the public sector program. Instead, oral contraceptives are manufactured in Egypt with assistance from the Government of Germany. We would needlessly complicate our lives to no avail by attempting to include non-AID provided contraceptives in any agreement with the GOE.

HRDC/P does not take serious issue with any of the three population-related recommendations in the report and in fact is already negotiating a new revenue agreement with the MOH and EPTC which should satisfy them all. However, in the interest of clarity and efficiency, we suggest they be consolidated into one comprehensive recommendation, the text of which appears on p. 6 of the aforementioned enclosed HRDC/P written comments on the audit report. 4/

Footnotes: See Inspector General Footnotes to Management's Response to Draft Report (Appendix 3).

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

M E M O R A N D U M

DATE: April 12, 1988

TO: J.R. Ferri, RIG/A

FROM: C. J. Mantione, HRDC/H

THRU: J. Sarn, HRDC/H

SUBJECT: Comments on Draft Audit of Income Generating Projects dated 3/27/88.

A) Recommendation No. 5, pages 19 - 20

Our response to the above recommendation remains the same as stated in the March 9, 1988 Mantione - Ferri memorandum. However, the project and AID have reviewed project funding requirements from the Special Account and both parties have agreed that because there will be sufficient income generated from the sales of ORS that the 1988 ORS production and distribution can be paid out of the Special Account. Therefore, the Contract for the 1988 ORS production and distribution will be negotiated and executed by the Project and comply to GOE procurement rules and regulations5/(TAB A).6/We will also advise that funds in the Special Project Account be moved to an interest bearing account if allowed under GOE regulations.

B. Recommendation No. 6

Since the ORS procurement will be carried out according to GOE procurement rules and regulation, AID will not need to approve the CID - NCDDP contract. However, in order to insure that a legal contract has been effectuated, we will require that the project provide AID with a signed copy of the contract. Because the contract will be funded through the Special Account, contract expenditures will be shown on quarterly financial reports covering Special Account expenditures.

The recommendation is well taken and we will adhere to M.O .5 - 4 requirements in future procurements.

Recommendation No. 7

The project has been advised that all foreign exchange necessary for any future AID funded ORS transactions (if any) will be provided by the GOE as required by the Grant Agreement in Section 4.4.

For current ORS production expenditures, AID will take steps to more closely review expenditures made to this line item. However, all future ORS expenditures will be funded by the GOE thru the Project Special Account.

Recommendation No. 8

As previously discussed the NCDDP will fund the 1988 ORS production and distribution contract out of the Project Special Account. As mentioned in the Mantione/Ferri memorandum dated March 9, 1988, page 2, "The project contemplates that in 1989, AID will no longer be funding ORS production". Should it be necessary for AID to fund future ORS production and distribution in part or totally, we will insist that any contract put forth for approval be accompanied by a record of negotiations, source and origin certificates and cost explanations. We will process the approval of the contract in accordance with AID procurement regulations and with M.O 5-4.

It is our belief that because of actions taken by the Health Office and the Project, the Audit Recommendations relevant to the Diarrheal Diseases Project be closed at this time.

Footnotes: See Inspector General Footnotes to Management's Response to Draft Report (Appendix 3).

المشروع القومي لمكافحة أمراض الإسهال

THE NATIONAL CONTROL OF DIARRHEAL DISEASES PROJECT

Mr. Charles Mantione
Program Officer
Health Office
USAID/Cairo

Date : Cairo 4/4/1988
Subj.: ORS Production

Dear Mr. Mantione,

Re our discussions with regard to NCDDP/CID Co. Contract for ORS Production, and based on the discussions about the preliminary reactions of USAID auditor; and for the sake of meeting the NCDDP mandate of making ORS widely available;

Please be informed that NCDDP has decided to budget 1988 contract for ORS production from the Special Account.

With best regards.

Sincerely yours,

A Nagaty

Dr. Ali Nagaty
Executive Director

APPENDIX 3

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

1. Regarding USAID/Egypt's comments that the report does not give any credit to USAID/Egypt's efforts, the Regional Inspector Office for Audit in Cairo (RIG/A/C) is not in a position to comment on untested aspects that are outside the scope of the audit. The audit was not directed to determining whether the distribution system worked efficiently or effectively.

2. USAID/Egypt commented that the draft report unfairly takes it to task in several places with statements that funds generated were not used to "further A.I.D. health objectives in the population and health area as expected" and similar statements. The Mission also said that the lack of an explicit revenue agreement does not mean that the actual use of these funds by EPTC was improper. The RIG/A/C believes the report statements are appropriate in view of the lack of control exhibited by the Mission over the use of such funds. We acknowledge that some of the funds used by EPTC may have been properly used. However, it is important to note that neither USAID/Egypt nor NPC had knowledge of the improper retention or to what purpose the funds were used in EPTC operations as determined by the audit. The final report was appropriately modified for the statements mentioned.

3. Regarding USAID/Egypt's point that the report is not always clear in the distinction between USAID and non-USAID contraceptive supplies managed by EPTC, the RIG/A/C clarified these sections of the report.

4. Other USAID/Egypt comments to the draft report were considered in preparing the final audit report. For brevity USAID/Egypt's comments to an earlier draft were not appended, but were considered and are available for review at the RIG/A/C office.

5. Concerning the execution of the 1988 ORS production contract according to GOE procurement rules and regulations, the Project Office should consult with its Legal Counsel to determine the extent to which A.I.D. procurement regulations apply when Special Account funds are used.

6. See Appendix 2 for TAB A document.

List Of Recommendations

Recommendation No. 4 14

We recommend that USAID/Egypt implement arrangements with the Government of Egypt to: (a) spend project income for mutually intended purposes; and (b) establish a budgeting, accounting, and reporting system to control the use of such funds. (Resolved upon issuance of report.)

Recommendation No. 5 14

We recommend that USAID/Egypt enter into an agreement with the Ministry of Health to: (a) transfer the special account to an interest-bearing bank account, so that idle funds will draw interest until used; and (b) change the present method of financing the project from A.I.D. advances to A.I.D. direct reimbursements at least until idle funds are reduced to a minimal acceptable level.

Recommendation No. 6 18

We recommend that USAID/Egypt: (a) have the National Control of Diarrheal Diseases Project disclose line-item costs in sufficient detail to allow proper USAID/Egypt review and approval of allowable costs; and (b) before approving the oral rehydration salt's supply contract for 1987 and 1988, ensure that the contract is properly cleared by USAID/Egypt officials, including the Mission Director, in accordance with Mission Order 5-4.

Recommendation No. 7 18

We recommend that USAID/Egypt pursue arrangements with the Government of Egypt so that the commodity importer for the oral rehydration salt procurements is provided the foreign exchange necessary for the A.I.D.-funded transactions. (Closed upon issuance of the report.)

Recommendation No. 8 23

We recommend that USAID/Egypt establish the reasonablness of the price for oral rehydration salts in accordance with Mission procurement regulations and the terms of the project paper which call for in-depth analysis of the supplier's production costs and pricing policies, before approving the 1987-88 supply contract. (Resolved upon issuance of the report.)

APPENDIX 5

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