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AUDIT OF
USAID/EGYPT'S PROCEDURES
TO REVIEW UNLIQUIDATED OBLIGATIONS

Audit Report No. 6-263-89-5
March 27, 1989

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL/AUDIT

March 27, 1989

MEMORANDUM FOR D/USAID/Egypt, Marshall D. Brown

FROM : RIG/A/Cairo, F. A. Kalhammer F. Kalhammer

SUBJECT : Audit of USAID/Egypt's Procedures to Review Unliquidated Obligations

The Office of the Regional Inspector General for Audit/Cairo has completed its audit of the USAID/Egypt's Procedures to Review Unliquidated Obligations.

The draft audit report was submitted to you for comment and your comments are included in the report. The report contains five recommendations.

Recommendation No. 2 is considered closed and requires no further action. Recommendation Nos. 1, 3, 4, and 5 are considered resolved, but cannot be closed until planned or promised corrective actions have been completed. Please advise me within 30 days of any additional actions taken to implement these recommendations.

I appreciate the cooperation and courtesy extended to my staff during the audit.

U.S. Mailing Address:
Box 10, RIG/A/C
FPO New York 09527-0008

106, Kasr El-Eini St.
Cairo Center Building
Garden City, Cairo, Egypt

Tel. Country Code (202)
No. 354-8211
Exts. 3345/6/7

EXECUTIVE SUMMARY

The USAID/Egypt Controller is specifically responsible for certifying for the Mission that the annual statement of obligations submitted each year to the Office of Management and Budget consists of valid obligations as defined in Section 1311 of the Supplemental Appropriations Act, 1955 (31 USC 1501). As of September 30, 1988, unliquidated obligations for USAID/Egypt projects and programs totaled about $2.3 billion.

The objectives of this financial and compliance audit were to: determine if USAID/Egypt's procedures for the review of unliquidated obligations were operating and effective; ascertain the extent of compliance with A.I.D. regulations; and test the adequacy of internal controls.

The audit showed that as of September 30, 1988, about $35 million in obligations and/or commitments were either no longer valid, not current, or not fully required for the purposes intended. The obligated amounts did not meet the criteria of Section 1311 of the Supplemental Appropriations Act of 1955 and the requirements of A.I.D. regulations. Internal controls were appropriate and operational except for a lack of adequate oversight and management controls that contributed to the problems cited.

For the fiscal year ended September 30, 1988, USAID/Egypt's certification of unliquidated obligations included about $35 million which could have been deobligated or reprogrammed before October 1, 1988. Three items, as described in succeeding paragraphs, constituted this $35 million: $11.3 million uncommitted in projects with expired completion dates; $1.3 million in expired commitments; and $22.1 million that remained unspent on projects far behind scheduled implementation. We recommended that USAID/Egypt improve oversight and management controls by completing a special, mid-fiscal-year review by April 30, 1989. The Mission agreed.

Nineteen USAID/Egypt projects with completion dates that expired on or before September 30, 1988, had uncommitted balances of $11.3 million. We recommended that USAID/Egypt deobligate the $11.3 million. Deobligation action has occurred and the recommendation is considered closed upon report issuance.

About $1.3 million within a $12.9 million sample of expired commitments was found to be unneeded and should have been reprogrammed. We recommended that USAID/Egypt review all expired commitments and decommit any unneeded funds. The Mission did not disagree on the facts presented but did draw a different conclusion from that of the auditors.

About $22.1 million remained unspent on components of two USAID/Egypt projects. The components had not progressed on schedule, but the Mission had not taken action to renegotiate the grant agreements. We recommended that this be done and that unneeded funds be deobligated after a determination of actual financial requirements is made. The Mission indicated general agreement.

Currency devaluations were not reflected in the budgets of three projects sampled during this review and thus no budget adjustments were made to reflect the $19.8 million surplus that had become available. We recommended that USAID/Egypt review all active project financial plans and make appropriate adjustments that take into account local devaluations, inflation, and actual local currency requirements at the current rate of exchange which continues to favor the dollar. The Mission stated it had issued appropriate instructions in this regard.

Mission management requested the following statement be included in the Executive Summary.

> "In order to lend some perspective to the problems the auditors discuss, it is important to remember that the pipeline for projects at September 30, 1988, was $1.8 billion. We believe the reasonable conclusion to be drawn from the audit report is that, on balance, the Mission is doing an excellent job of identifying possible deobligations and decommitments. The cases discussed by the auditors were known to the Mission and had been discussed and analyzed by Mission staff and management.
>
> "The Mission tries to be cautious and sensitive to the political implications of premature decommitments and deobligations. Since deobligations prior to the PACD of a project require host country concurrence, if AID does not have deob/reob authority in the fiscal year the

> desirability of an actual project deobligation becomes apparent, it may be politically more sensible to let the PACD expire and allow for unilateral deobligation of unneeded funds.
>
> "For this reason there are occasions where deobligations or decommitments have not been effected which, in hindsight, could have been effected. We do not believe that, under the circumstances, these findings of this report represent a significant deviation from the spirit of section 1311 on the part of the Mission."

USAID/Egypt representatives indicated further that the normal quarterly project review process would be strengthened and greater Controller involvement would focus attention on the financial/compliance matters which are the subject of this report as an integral part of those periodic reviews.

Detailed Mission comments on the draft report are to be found at the end of each finding section and are presented in their entirety as Appendix 1. Office of Inspector General comments are also contained at the end of each finding section.

Office of the Inspector General

AUDIT OF
USAID/EGYPT'S PROCEDURES
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AUDIT OF
USAID/EGYPT'S PROCEDURES TO
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PART I - INTRODUCTION

A. Background

The USAID/Egypt Controller is responsible for periodically reviewing the status of funds to ascertain whether obligations are valid, current, and fully required for the purpose intended, and to take action to deobligate and/or decommit funds determined to be in excess of requirements. He is specifically responsible for certifying on behalf of USAID/Egypt that the annual statement of obligations submitted each year to the Office of Management and Budget consists of valid obligations as defined in Section 1311 of the Supplemental Appropriations Act of 1955 (31 USC 1501). Obligated amounts should be subjected to continuous review by fiscal, program and other appropriate officers to ensure their continued validity for their intended purpose. As of September 30, 1988, unliquidated obligations under USAID/Egypt's projects and programs totaled $2,278,015,000.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Cairo made a financial and compliance audit of USAID/Egypt's procedures to review approximately $2.3 billion in unliquidated obligations for projects and programs, as of September 30, 1988. The audit objective was to evaluate the adequacy and management oversight of the Mission's procedures to review unliquidated obligations. Specifically, we wanted to determine if the unliquidated obligations were: (1) valid, current, and fully required for the purpose intended in accordance with Section 1311 of the Supplemental Appropriations Act of 1955; (2) in compliance with A.I.D. regulations; and (3) subject to adequate internal controls.

The work was done at the offices of USAID/Egypt in Cairo during the period from July 1988 through February 1989. Project records and financial reports and data were examined and tested as deemed appropriate. Interviews and discussions were held with appropriate Mission personnel in the Office of Financial Management, Program Office, and with selected project officers.

Nineteen obligating documents totaling $11.3 million for all projects whose completion dates had expired during the period between July 31, 1987 and September 30, 1988 were reviewed for validity. A total of $12.9 out of $88.7 million in expired commitments, selected on the basis of being at least 9 months old and over $100,000, were reviewed for validity. Of USAID/Egypt's total of 79 active projects worth about $5.1 billion, five ongoing projects, one from each USAID/Egypt directorate, were selected judgmentally to review the validity of their unliquidated obligation balances. Three of these five projects were also reviewed to determine how dollars budgeted therein to buy local currency had been affected by devaluation of the Egyptian pound.

The review of internal controls and compliance was limited to the findings in this report. This audit did not include operating expense funds (the subject of a prior RIG/A/C audit) or local currency trust funds. The audit was made in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The audit showed that as of September 30, 1988, about $35 million in project obligations and/or commitments were either no longer valid, not current, or not fully required for the purposes intended. The obligated amounts did not meet the criteria of Section 1311 of the Supplemental Appropriations Act of 1955 and the requirements of A.I.D. regulations. Internal controls were appropriate and operational except that certain periodic reviews were not performed and a relatively small number of errors were made which contributed to the problems cited.

Other than these matters, there was an adequate level of compliance with applicable laws and A.I.D. regulations. USAID/Egypt financial management officials took action to deobligate almost $12.6 million in expired project obligations prior to the conclusion of the audit.

For the fiscal year ended September 30, 1988, USAID/Egypt's certification of unliquidated obligations included about $35 million which could have been deobligated or reprogrammed before October 1, 1988. There were 19 USAID/Egypt projects with completion dates that expired on or before September 30, 1988, which had uncommitted balances of $11.3 million. Also, about $1.3 million in expired commitments were unneeded and could have been reprogrammed. About $22.1 million remained unspent in certain components of two USAID/Egypt projects. These components had not progressed on schedule, but the Mission had not taken action to renegotiate the grant agreements. Finally, local currency devaluations were not taken into consideration and thus budget adjustments were not made to reflect project surpluses that became available.

We recommended completion of a mid-fiscal-year 1311 review by April 30, 1989; deobligation of $11.3 million in expired project obligations; review of all expired commitments and decommitment of any unneeded funds; renegotiation of two grant agreements and deobligation of any unneeded funds; and review of all active project financial plans and adjustment, as appropriate, of life-of-project local currency budgets.

A. Findings and Recommendations

1. Oversight of 1311 Reviews Could Be Strengthened

Section 1311 of the Supplemental Appropriations Act of 1955 (31 U.S.C. 1501) requires agencies to certify that unliquidated obligation balances are needed at the end of each fiscal year. For the fiscal year ended September 30, 1988, USAID/Egypt's certification of unliquidated obligations included about $35 million which could have been deobligated or decommitted and reprogrammed before October 1, 1988. This occurred because the Mission did not exercise adequate oversight and management controls to ensure effective implementation of continuous, mid-year or year-end reviews of unliquidated obligations. As a result, some $35 million in unneeded A.I.D. funds were not redirected to other uses under the Egyptian program, and within that amount, some $11.3 million in expired project commitments became unavailable for use in Egypt.

Recommendation No. 1

USAID/Egypt should complete a special, mid-fiscal-year 1311 review, as required by A.I.D. Handbook 19, by April 30, 1989.

Discussion

A.I.D. guidelines to implement Section 1311 of the Supplemental Appropriations Act of 1955 are set forth in Chapter 2 of A.I.D. Handbook 19. Chapter 2 incorporates the requirements of the Act and includes supplemental criteria for evaluating whether unliquidated obligations are still valid. The USAID/Egypt Office of Financial Management is responsible for devising, implementing, and maintaining a comprehensive system for the control of obligations against allotments. This system should subject all obligations to a continuous and comprehensive review process within the requirements of Section 1311. Special mid-year and end-of-year reviews of unliquidated obligations are also required each fiscal year.

During the fiscal year ended September 30, 1988, the Office of Financial Mananagement's 1311 review of unliquidated obligations resulted in deobligations and reobligations totaling $13.6 million. However, an additional $35 million could have been deobligated or reprogrammed prior to the end of fiscal year 1988. Nevertheless, those funds were included in the annual 1311 certification made by the

USAID/Egypt Controller. Subsequent to the end of the fiscal year (audit cut-off-date), the Office of Financial Management deobligated about $12.6 million in unneeded commitments within the $35 million which we had identified.

These unneeded commitments were not identified because USAID/Egypt did not exercise adequate oversight and management controls to fully comply with the requirements of A.I.D. Handbook 19. Specific mid-year and year-end reviews were not made. Instead, the Mission relied upon its continuous review process. Based on Findings 2, 3, and 4 presented in this report, we have concluded that such continuous reviews have not been entirely effective and that Mission oversight of the 1311 review process could be enhanced.

In conclusion, prior to September 30, 1988, USAID/Egypt should have taken action on unliquidated obligations which were no longer needed for their original purposes, or for which Project Activity Completion Dates (PACDs) had occurred, or under which commitments had expired. As a result, unneeded obligations such as those identified in this review were not redirected to higher priority uses, and at least $11.3 million in expired project commitments became unavailable for use in Egypt.

Management Comments

USAID/Egypt agreed to fully implement the recommendation.

Office of the Inspector General Comments

The recommendation is considered resolved upon issuance of this report and can be closed when the special review is completed and its results are analyzed.

2. <u>Uncommitted Balances with Expired PACDs Needed to Be Deobligated</u>

Nineteen USAID/Egypt projects with Project Assistance Completion Dates (PACDs) that occurred on or before September 30, 1988, had uncommitted balances of $11.3 million (see Exhibit 1). Such amounts, according to AID Handbook 19, are subject to deobligation.

The action to deobligate available balances was not initiated for various reasons: such as waiting for the Terminal Disbursement Date (TDD); expected future use of the funds; or because the responsibility was divided between the Project Officers, Program Office, and Office of Financial Management. The result is that $11.3 million could be returned to the U.S. Government if deobligation action is completed as required.

<u>Recommendation No. 2</u>

USAID/Egypt should deobligate $11.3 million in expired project commitments, as per Exhibit 1.

<u>Discussion</u>

According to Handbook 19, Project Agreements contain time controls based on the PACD by which it is estimated that AID-financed project assistance will be complete, services performed, and all goods furnished. The PACD provides a positive (but not automatic) reference point for concluding A.I.D. assistance because, unless it agrees otherwise, A.I.D. will not issue or approve documentation which will authorize the provision of services or the furnishing of goods after the PACD. Amounts obligated which are not needed to pay for goods and services delivered by the PACD, as amended, are considered invalid and subject to deobligation.

Nineteen projects, (see Exhibit 1) expired during the period from July 31, 1987 to September 30, 1988, leaving uncommitted balances ranging from $8,000 to $4.9 million, and totaling $11.3 million. None of the PACD's extended beyond September 30, 1988, and as such, the $11.3 million is subject to deobligation. The responsibility to initiate action to deobligate funds is divided among Project Officers, Program Office, and Financial Management. For example, during the fiscal years 1983 thru 1988, the action for deobligation was taken jointly by the Office of Financial Management and the Program Office at the end of each fiscal year. 1/

Some project officers whom we interviewed felt reluctant to take any action to deobligate invalid balances at this point. They preferred to wait until the TDD to deobligate uncommitted funds together with any undisbursed commitments. Such a joint one-time action, in their opinion, would save duplication of effort. Other project officers had no objection to deobligating funds at this time, but they believed that the Office of Financial Management should initiate action.

Management Comments

Financial Management officials agreed that the $11.3 million should be deobligated. This action has been completed, and with some modifications to the listing shown in Exhibit 1, the total deobligated was a little under $12.6 million. Mission management took note of the fact that the majority of the PACD's had occurred at the very end of the fiscal year. They also commented that deobligating program funds in Egypt before a PACD has passed involves more than just fiscal considerations. (See Appendix 1)

Office of the Inspector General Comments

Based on the Mission's actions and the documentation provided, Recommendation No. 2 is closed upon issuance of the report.

1/ For the past several years, Congress has authorized A.I.D. to effectively retain deobligated funds by permitting them to be "reobligated" for the same general purposes as originally authorized within the same Mission or geographic Bureau. This special authority was unexpectedly withdrawn under the ESF account because technical foreign assistance budget limitations arose during Conference Committee proceedings which preceded passage of the FY 89 appropriations bill. Since all A.I.D. activities in Egypt are funded from the ESF account, the Mission currently has no alternative but to deobligate funds once a PACD has occurred.

3. Expired Commitments Should Be Reviewed and Unneeded Funds Reprogrammed

Our review of a sample of expired commitments totaling $12.9 million, as of December 31, 1987, showed that about $1.3 million was unneeded and should have been reprogrammed. A.I.D. regulations state that any unliquidated balances in an expired commitment document, which are in excess of the amounts required to cover goods and services, may be considered invalid. 2/

2/ Under A.I.D.'s system of project obligations, funds appropriated by the Congress are obligated with the execution of bilateral project agreements which are, in effect, contracts between two sovereign governments. As contracts for goods and services are let, purchase orders executed, persons sent off for training, etc. under those agreements, funds are then considered to be "committed." Such commitments are usually regarded as "obligations" in normal federal accounting parlance. A.I.D. is understandably reluctant to "deobligate" funds under an active project agreement before its PACD has occurred because such actions require, during the normal course of business between sovereign governments which enjoy friendly relations, agreement by the recipient government that the funds are no longer needed. Such agreement is often difficult to obtain because Project Agreements are very generally worded (and purposely so) in order to permit minor mid-course modifications without having to amend the agreement itself. Thus, more equipment can be purchased, technical assistance extended, geographic coverage expanded, etc. if funds committed for one purpose prove to be in excess of needs originally budgeted for. Hence, such monies need only be "decommitted" under a particular contract, letter of commitment, etc., and "recommitted" elsewhere within the same project. In addition, it has been rightly pointed out that it often takes years for provisional overhead rates under A.I.D. contracts to be finalized, and funds need to be retained under such commitments until the rates are finally settled.

Fifteen commitment documents that had expired during the period between October 1983 and December 1987 had not been acted upon as of September 30, 1988. This was because the Office of Financial Management's system for reviewing and reporting on the validity of maintaining commitments past their termination dates lacked effective oversight. This resulted in substantial amounts being encumbered in expired commitments. We believe that USAID/Egypt's Office of Financial Management needs to review all expired commitments and decommit any unneeded funds, and to initiate more critical reviews to ensure that expired commitments are decommitted on a timely basis.

Recommendation No. 3

USAID/Egypt's Office of Financial Management should review all expired commitments and decommit any unneeded funds not later than April 30, 1989.

Discussion

As of September 30, 1988, the total of expired commitment documents had reached about $88.7 million. For our audit sample, we selected all expired commitments 9 months or older, (i.e., as of December 31, 1987) and over $100,000. This selection yielded 38 expired commitment documents totaling $12.9 million, or about 14.5 percent of the total amount. Among those 38 documents, we found that 15 had questionable commitment balances totaling $4.6 million (See Exhibit 2).

As a result of interviews with cognizant Mission officials, we concluded that about $1.8 million of the latter figure remained valid, while the remaining $2.8 million appeared to be in excess of project needs. Of this amount, our discussions with financial management (FM) staff identified six truly excess commitment balances totaling $1.3 million.

The six commitments found to be unneeded included five commitment documents totaling $1.1 million and one for $206,346 which had been mistakenly charged to an incorrect Letter of Commitment. The five commitments totaling $1.1 million were reprogrammed during October, November, and December 1988 and the erroneous charge was corrected.

AID Handbook 19, Chapter 2, Section 2M.2b. states that when all the goods, services or training under the obligating document have been received, any unliquidated balance in excess of the amount required to cover goods delivered and services performed for which payment has not been made is to be deobligated. Generally, A.I.D. procedures allow 9 months after the PACD to settle unliquidated balances.

The $4.6 million in expired commitments shown in Exhibit 2 was over 9 months old as of September 30, 1988. According to FM staff, action to review these expired commitments and reprogram unneeded amounts started in March 1988, but had not been completed as of September 30, 1988, for a variety of reasons. In certain cases final invoices were not received; in others payments were made by A.I.D./Washington and the Advices of Charge had not been received; in still others project officers could not determine how much was needed in expired commitments to cover any outstanding payments or settlements of claims and disputes; and in one case there had been an error in charging the wrong Letter of Commitment, which remained uncorrected for 5 years.

In sum, unneeded balances in expired commitment documents were not acted upon by FM on a timely basis. USAID/Egypt's system for reviewing expired commitments should routinely identify all unneeded commitments on a timely basis to avoid having large amounts unneccessarily encumbered.

Management Comments

Although agreeing with the factual material in this section of the report, the Mission drew a different conclusion from that of the auditors. In FM's view, the $1.3 million in questionable commitments identified by the audit indicates "an excellent job in identifying and decommitting uncommitted balances."

Office of the Inspector General Comments

The report clearly states that we reviewed a sample of expired commitments totaling $12.9 million and found that about $1.3 million was unneeded and should have been reprogrammed. What is important is the error rate: 6 out of 38 items checked needed corrective action (16%). We would not suggest this rate should be projected to the universe of commitment documents, but neither would we suggest that it represents an "excellent" or even an acceptable error rate.

The recommendation is considered resolved upon issuance of this report and will be closed when a satisfactory review of expired commitments has been completed.

4. USAID/Egypt Needs to Renegotiate Two Grant Agreements and Reprogram or Deobligate Unneeded Funds

About $22.1 million remained unspent in components of two USAID/Egypt projects. The components have not progressed on schedule, but the Mission had not taken action to renegotiate the grant agreements. A.I.D. regulations provide for appropriate remedial action in such cases. Both projects, for which a total of $43 million was obligated, suffered long delays caused by their respective Government of Egypt implementing agencies. Thus, of the $43 million obligated, about $22.1 million remained unspent and may no longer be required.

Recommendation No. 4

USAID/Egypt should determine actual life-of-project financial requirements and, if appropriate, renegotiate the two grant agreements and deobligate any unneeded funds.

Discussion

Five projects, one from each USAID/Egypt directorate, were selected for review (See Exhibit 3). We wanted to determine if implementation was progressing according to schedule, and whether unliquidated obligations remained valid. Two projects, Private Investment Encouragement Fund No. 263-0097 and Sector Development and Support Fund No. 263-0161.06, were far behind schedule.

A.I.D. Handbook 19, Chapter 2 requires continuous review of unliquidated obligation balances to ensure that recorded obligations are valid for the Agency Controller's certification under the provisions of 31 U.S.C. 1501. Moreover, the Handbook states that, "When the project implementation has not progressed on schedule, consideration is given to renegotiating the agreement and adjusting the obligation downward as required."

Private Investment Encouragement Fund Project No. 263-0097 - The project agreement was signed on September 22, 1979, for $33 million to provide resources for medium- to long-term credit for private sector projects. After 9 years of project implementation, only $17.8 million was committed, leaving $15.2 million uncommitted due to long delays in loan processing, and extensive bureaucratic controls and procedures imposed by the implementing agency.

In July 1988 USAID/Egypt decided to terminate the project because of its weak performance and deobligate the uncommitted balance. Subsequently, AID/Washington informed the Mission that ESF reobligation authority had not been extended in FY 1989; therefore the funds, if deobligated, would be "lost" to the Egyptian program. USAID/Egypt thus decided in December 1988 to extend the project for 2 more years with new conditions similar to those of the Private Sector Commodity Import Program. This proposed extension was in process and had not yet been finalized.

Sector Development and Support Fund Project No. 263-0161.06 - The project was signed on August 29, 1982 for $10 million to strengthen the decentralization process in Egypt. Two of the project's five components, the Sakkara Training Center for $4.3 million and the Training Block Grant for $2.6 million, had not shown much progress since inception of the project in 1982. These components were supposed to have been operating several years ago. However, the Government of Egypt has not provided the administrative and technical staff, or the necessary financial support system.

USAID/Egypt has tried repeatedly to address the GOE's administrative problems. In the most recent effort, a Project Implementation Letter prepared in October 1988, in the hope of resolving all outstanding issues, had not been agreed to by the GOE Project Chairman, as of December 31, 1988. Thus the Sakkara Training Center and the Training Block Grant, along with the $6.9-million uncommitted balance, were immobilized and no training objectives had been achieved.

Since there had been so little progress made in achieving some of the stated objectives under these two projects, about $22.1 million of A.I.D. funds have remained idle for periods of up to 9 years in some cases. Action needs to be taken to correct this long-standing situation.

Management Comments

The Mission concurred in the recommendation and is engaging appropriate GOE officials in a discussion of options regarding the two grant agreements.

Office of the Inspector General Comments

The recommendation is considered resolved upon issuance of the report and will be closed when the actual financial requirements of the two grant agreements have been determined and appropriate action has been taken.

5. Local Currency Devaluations Should Be Reflected in Project Budgets

Most of USAID/Egypt's projects have allocated varying amounts of U.S. dollars for conversion at the highest rate not unlawful to pay for expenses incurred in local currency. The rate of exchange has changed significantly from $1 = LE0.83 in August 1986 to approximately $1 = LE2.35 at the end of this audit. In three projects that we reviewed, devaluations of the Egyptian pound created a surplus of about LE46.5 million, or $19.8 million. Currency devaluations were not taken into consideration in two of the projects, and thus no budget adjustments were made to reflect the surplus that became available. Under one of the projects, currency devaluation was taken into consideration but the budget was not adjusted accordingly. Thus, even in this case there was a substantial surplus created. Savings may be available under these projects, and probably others, as the Mission expects to disburse $133 million this year alone for local currency project costs.

Recommendation No.5

USAID/Egypt should review all active project financial plans and adjust the dollar amounts allocated for local expenses to take into account life-of-project local currency requirements at the current rate of exchange.

Discussion

Three projects, Agricultural Production Credit No. 263-0202; Sector Development and Support Fund No. 263-0161.6; and Population/Family Planning No. 263-0144, were selected to determine how dollars to be converted to local currency were affected by devaluations of the Egyptian pound.

The three grant agreements, and their amendments, had a combined total of $52,261,000 allocated for local expenses, (see Exhibit 4). Egyptian pound requirements were LE76,322,600 at the best legally available exchange rates at the time the agreements or their amendments were signed. After several major changes in the exchange rate, project dollars budgeted to defray local costs would produce LE122,813,350, or an increase of LE46,490,750 (61 percent).

None of the three project budgets had been adjusted to reflect the large amounts made available as a result of the Egyptian pound devaluation from $1 = LE0.83 in August 1986 to the current rate of $1 = LE2.35. The rate is expected to continue to change in favor of the dollar. One project officer told us that the budget will not be adjusted because the surplus is needed to offset additional costs incurred as a result of inflation, which has been running at a rate of between 10 and 20 percent in the last few years. 3/ Another project officer stated that he took over responsibility for managing the project only recently, and it did not occur to him to consider adjusting the project's financial plan as a result of changes in the exchange rate. The third project officer said that the Egyptian pound devaluations were taken into consideration each time the agreement was amended. Basically, when preparing amendments, project officials used surplus funds available to cover the upcoming needs of the project at the prevailing exchange rate. This procedure notwithstanding, a substantial surplus had been created.

We also discussed the issue of exchange-rate-induced surpluses with a Financial Management official. He believed that budgets should sometimes be adjusted as a result of implementation problems not foreseen during the project design stage, but not because of local currency devaluations. This despite the fact that the amount of unliquidated obligations has remained substantial due to slow rates of disbursement from available project funds.

The increase of 61 percent amounting to LE46,490,750, or about $19.8 million for three projects, makes it worthwhile to review all active USAID/Egypt projects to determine the amounts that could be saved by adjusting project financial plans. USAID/Egypt expects to disburse about $133 million this year to buy local currency for AID project-related costs.

Management Comments

The Mission agreed generally with the recommendation but believes that the finding is "misleading" and "tries to create the impression that the actual effect of the finding is greater than it is in reality." The Mission also states

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3/ Depending on which consumer price index one wishes to rely on.

that since 1986 they have specifically taken currency devaluation into account. They requested recommendation closure based on future planned reviews of project budgets to determine the net effect of Egyptian Pound devaluations.

Office of the Inspector General Comments

We believe that we have taken a straightforward approach to cover an important element in financial planning that has often been overlooked by Mission project officials in the past. The surplus of about $19.8 million created by devaluations of the Egyptian pound in the three projects we reviewed illustrates this, and therefore we cannot agree that currency devaluations have been taken into account since 1986. In our opinion, the Mission would be well served to review all pertinent financial plans and make appropriate adjustments.

We consider the recommendation resolved upon issuance of the report. However, the recommendation remains open until we receive evidence that fully-funded project budgets have been reviewed and adjusted to reflect the net effect of local currency devaluations.

B. Compliance and Internal Controls

Compliance

In the areas audited, there was an adequate level of compliance with applicable laws and A.I.D. regulations except that USAID/Egypt was not taking sufficient action to ensure that Section 1311(a) of the Supplemental Appropriations Act, 1955 (31 USC 1501) and related A.I.D. regulations were followed. Specifically, mid-fiscal-year and year-end reviews of unliquidated obligations and expired commitments were not being made, per A.I.D. Handbook 19 guidance. Nothing else came to our attention that indicated noncompliance in areas not tested.

Internal Controls

Internal controls in the recording and reporting of financial information pertaining to unliquidated obligations for USAID/Egypt projects and programs were appropriate and operating in a satisfactory manner except for the lack of adequate oversight and management controls that resulted in the findings reported.

AUDIT OF
USAID/EGYPT'S PROCEDURES
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PART III - EXHIBITS AND APPENDICES

EXHIBIT 1

UNCOMMITTED AMOUNTS IN PROJECTS WHOSE PACD HAD PASSED
AS OF SEPTEMBER 30, 1988

PROJECT NO. 263-	TITLE	PACD	UNCOMMITTEI $ (000)
0009	Ismailia Thermal Power Plant	09/30/88	140
0012	Suez Cement Plant	09/30/88	117
0016	Applied Science & Technology	06/30/88	286
0023	National Energy Control Center	07/31/87	209
0026	Technology Transfer & Manpower Dev. III	10/10/87	157
0027	Rice Research & Training	02/28/87	45
0029	Family Planning	09/30/87	235
0048	Canal Cities Water & Sewerage	09/30/88	1,888
0052	Quattamia Cement Plant	09/27/88	270
0061	Development Planning Studies	03/31/88	8
0064	Aquaculture Development	10/31/87	56
0066	Helwan Housing Community	08/26/88	1,562
0079	Small Farmer Production	07/31/87	87
0090.02	Vocational Training for Production	09/30/88	420
0091	Cairo Sewerage I	09/30/88	233
0115	Tax Administration	09/30/88	269
0142	Data Collecton and Analyses	05/31/88	85
0159	Business Support & Investment	09/30/88	4,956
0161.02	Basic Villages Services	04/30/88	272
			11,295

Source: MACS P19 Report
as of 11/30/88

EXHIBIT 2

REVIEW OF OBLIGATIONS WITHIN EXPIRED COMMITMENTS
AS OF SEPTEMBER 30, 1988

COMMITMENT DOC. NO.	EXPIRED ON	BALANCE	QUESTIONED AMOUNTS	
263-0016-6-80403	10/01/83	$ 206,346	$ 206,346	4/
263-0030-05	12/31/86	269,444	260,980	2/
263-0090.02-02	03/16/87	1,364,336	612,620	3/
263-0023-05	07/31/87	116,256	59,791	3/
263-0023-04	07/31/87	207,246	140,984	3/
PS-NE-0026-P-HA-6086	08/10/87	145,977	145,977	3/
263-0038-06	09/28/87	425,596	300,000	1/
263-0029-05	09/30/87	138,975	138,975	3/
PS-EGY-0142-P-AG-1060	11/30/87	710,387	105,529	1/
263-0101-45	12/31/87	302,065	246,510	2/
263-0101-48	12/31/87	219,533	176,139	2/
263-0101-57	12/31/87	152,460	105,438	2/
263-0101-47	12/31/87	146,701	108,894	2/
263-0101-49	12/31/87	127,263	110,577	2/
263-0165-01	12/31/87	112,989	112,989	2/
TOTAL		$ 4,645,574	$ 2,831,749	

Footnotes

1/ After 9/30/88, these commitment documents were extended beyond 12/31/87.

2/ No action can be taken at this point, as future payments and Advices of Charge are still expected.

3/ After 9/30/88, these invalid balances were decommitted; thus no further action is required.

4/ This amount was mistakenly charged to Letter of Commitment No. 263-0016-6-80353 instead of to the one shown.

Source: MACS report dated 10/11/88, titled: "All Expired Commitments with Unexpended Balances," as of 9/30/88.

EXHIBIT 3

SUMMARY OF PROJECTS WITH IDLED AMOUNTS
(POTENTIALLY INVALID OBLIGATIONS)
AS OF SEPTEMBER 30, 1988

Project No.	T i t l e	Obligation $(000)	Amount Inoperativ $(000)
263-0097	Private Investment Encouragement Fund	33,000	15,200
263-0161.06	Sector Development and Support Fund	10,000	6,900
263-0202	Agriculture Production Credit	120,000	-0-
263-0144	Population, Family Planning	74,000	-0-
263-0102	Tech. Coop. and Feasibilities Studies	39,000	-0-
		$276,000	$22,100

EXHIBIT 4

SUMMARY OF DOLLAR FUNDS ALLOCATED FOR LOCAL EXPENSES
AS OF SEPTEMBER 30, 1988

Project Title/Number	Dollars Budgeted 1/	Egyptian Pound Equivalent 2/	3/	Difference
Population/Family Planning 263-0144	$40,687,000	LE62,646,530	LE95,614,450	LE32,967,920
Agriculture Production Credit 263-0202	6,434,000	9,409,870	15,119,900	5,710,030
Sector Development & Support Fund 263-0161.06	5,140,000	4,266,200	12,079,000	7,812,800
Totals	$52,261,000	LE76,322,600	LE122,813,350	LE46,490,750

FOOTNOTES:

1/ Represents all dollar amounts in project agreements and amendments for conversion to local currency.

2/ Calculated at the highest rate not unlawful on the date of signing the agreement or amendments.

3/ Calculated at $1 = LE2.35.

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APPENDIX 1

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

MAR 15 1988

MEMORANDUM

MAR 13 Rec'd

TO: Mr. Frederick A. Kalhammer, RIG/A/Cairo

FROM: Marshall D. Brown, Director

SUBJECT: Draft Audit Report: - USAID/Egypt's Procedures to Review Unliquidated Obligations

The Mission's comments on the draft audit report will follow the audit report's organization. Our portion of the executive summary is attached as a separate item (Attachment One).*

AUDIT RECOMMENDATION NO. 1

USAID/Egypt should complete a special, mid-fiscal-year 1311 review as required by A.I.D. Handbook 19, by April 30, 1989.

USAID RESPONSE

The Mission has agreed to do a special mid-year review of unliquidated obligations to comply fully with Handbook 19 guidelines and this recommendation.

AUDIT RECOMMENDATION NO. 2

USAID/Egypt should deobligate $11.3 million in expired project commitments, as per Exhibit 1.

USAID RESPONSE

As stated by the draft report, the balances reported have all been deobligated. It should be noted that of the $11.3 million shown in Exhibit 1, $8.3 million (73%) had PACD expiration dates of 9/30/88 (or in one case, 9/27/88). All of these balances were deobligated in the first quarter following the expiration of the PACD.

Audit Note: USAID/Egypt's Attachment One is not included in this appendix. Pertinent material contained therein is included at the end of the Executive Summary.

In the context of our continuing relationship with the Government of Egypt, to have deobligated them any earlier would have meant the deobligation would come before the PACD and would have, therefore, been subject to negotiations with the Government of Egypt, in accordance with HB 19, 2M2d. While this, no doubt, would have been preferable from a Section 1311 standpoint, the political cost of taking this direction would have been great. It should also be noted that the loss of Deob-Reob authority was not known until after the end of fiscal year 1988. In our opinion, the political cost of deobligating funds before the PACD would not have been offset by the relatively small gain accruing to the U.S. Government from an earlier deobligation.

AUDIT RECOMMENDATION NO. 3

USAID/Egypt's Office of Financial Management should review all expired commitments and decommit any unneeded funds not later than April 30, 1989.

USAID RESPONSE

We do not disagree with any of the factual material in this section, although we draw a different conclusion from that of the finding. Given the size and complexity of our pipeline, we believe the fact that only $1.3 million in questionable commitments were found shows that USAID/Egypt's Office of Financial Management as well as other parties involved have done an excellent job in identifying and decommitting uncommitted balances. The report itself admits that even these relatively small balances were under active review by FM and were decommitted in the first quarter of the following fiscal year. As in the case of deobligations mentioned above, we are talking about timing. The Mission generally tries to avoid premature decommitments and deobligations. In doing so there is an undeniable risk of having some obligations and commitments on the books which, in hindsight, should not have been there.

AUDIT RECOMMENDATION NO. 4

USAID/Egypt should determine life-of-project financial requirements and, if appropriate, renegotiate the two grant agreements and deobligate any unneeded funds.

USAID RESPONSE

The Mission agrees with the recommendation and it is in the process of active discussion of options with appropriate GOE officials.

AUDIT RECOMMENDATION NO. 5

USAID/Egypt should review all active project financial plans and adjust the dollar amounts allocated for local expenses to take into account life-of-project local currency requirements at the current rate of exchange.

USAID RESPONSE

We agree that changes in exchange rates can cause significant changes in dollar amounts budgeted for local currency expenses. However, as explained below and at the exit conference, we believe that the finding is misleading. Since 1986, the Mission has specifically taken currency devaluation into account, as well as the countervailing effect of the significant inflation which accompanied it, whenever incremental funding was required or project agreements amended. The Mission wishes to emphasize its position that "exchange rate windfalls" are only one element of financial plans that are subject to change and need to be periodically reviewed. We also note that the audit report mentions the effect of local cost inflation in Egypt since 1986 only in passing. While inflation did not fully offset the devaluation "windfall" it did make the effect of devaluation much less dramatic than implied by the report. We believe that the audit does not present fairly the situation and tries to create the impression that the actual effect of the finding is greater than it is in reality. We believe an attempt to quantify the effects of inflation would have lent balance to the report.

We believe the recommendation is a sensible one but only in the context of overall financial plan reviews. For projects which are not fully funded we intend to thoroughly review the issue when incremental funding is added. For fully funded projects I have instructed the Associate Directors to review their project budgets to determine the net effect of the devaluation of the Egyptian Pound. We therefore request that this recommendation be closed.

APPENDIX 2

LIST OF RECOMMENDATIONS

	Page
Recommendation No. 1	4
USAID/Egypt should complete a special, mid-fiscal-year 1311 review, as required by A.I.D. Handbook 19, by April 30, 1989.	
Recommendation No. 2	6
USAID/Egypt should deobligate $11.3 million in expired project commitments, as per Exhibit 1.	
Recommendation No. 3	9
USAID/Egypt's Office of Financial Management should review all expired commitments and decommit any unneeded funds not later than April 30, 1989.	
Recommendation No. 4	12
USAID/Egypt should determine actual life-of-project financial requirements and, if appropriate, renegotiate the two grant agreements and deobligate any unneeded funds.	
Recommendation No. 5	14
USAID/Egypt should review all active project financial plans and adjust the dollar amounts allocated for local expenses to take into account life-of-project local currency requirements at the current rate of exchange.	

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APPENDIX 3

REPORT DISTRIBUTION

	No. of Copies
Mission Director, USAID/Egypt	10
Assistant Administrator, Bureau for Asia and Near East (ANE)	2
Office of Egypt Affairs (ANE/E)	3
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Assistant Administrator, Bureau for External Affairs (XA)	2
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