PD-ABD-896
76114

Regional Inspector General for Audit
Cairo, Egypt

Audit of USAID/Egypt's Management of the Section 416(b) Food Donation Program

Report No. 6-263-92-07
March 26, 1992

INSPECTOR GENERAL

USAID

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

March 26, 1992

MEMORANDUM FOR D/USAID/Egypt, Henry H. Bassford

FROM : RIG/A/C, Philippe L. Darcy

SUBJECT: Audit of USAID/Egypt's Management of the Section 416(b) Food Donation Program

Enclosed are ten copies of our audit report on USAID/Egypt's Management of the Section 416(b) Food Donation Program, Report No. 6-263-92-07. The report contains one recommendation which we consider resolved and closed based on recent actions taken by the Mission as a result of this audit.

In finalizing this report, we fully considered your comments on the draft report and have included them as Appendix II to this report. Regarding the impairments that Mission management placed on the audit by refusing to provide requested written representations, your comments reflect some misunderstandings of generally accepted government auditing standards.

The audit profession has been one of constant evolution, and the standards and the changes to those standards are not always understood by management. The application of generally accepted government auditing standards is not simply a matter of a layman reading a technical book, understanding the technicalities, and then applying this understanding. Rather, the application of those standards is a matter of the auditor's professional judgement which comes from organizational guidance, supervision, and the auditor's experience and training.

While there is no way that we can convey to you in an audit report everything that we have learned through years of audit experience and training, we have tried to address each of your misunderstandings in Appendix V to this report. We would hope that our

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comments will resolve these misunderstandings and that Mission management will provide the auditor all requested evidential matter in the future. Please understand that generally accepted government auditing standards do require us to report impairments placed on our audit by management and the impact of those impairments on our audit work.

Please feel free to call upon me to discuss these issues or any other matters of concern to you. I appreciate the courtesies extended to my staff during the audit.

Background

On May 21, 1991, pursuant to Section 416(b) of the Agriculture Act of 1949, as amended, the U.S. government executed an agreement to deliver $55 million of agricultural commodities to the Government of Egypt (GOE):

• Butter-oil	5,785 metric tons
• Sorghum	100,000 metric tons
• Corn	300,000 metric tons

This commodity assistance was designed to provide both foreign exchange and budgetary support. The Gulf Crisis had (1) reduced Egypt's traditional sources of foreign exchange--worker remittances and tourism--and (2) strained its domestic resources with the unexpected repatriation of hundreds of thousands of workers and their families from Iraq and Kuwait. It was intended that this assistance would

- enable the GOE to save $55 million in foreign exchange by canceling commodity orders it might otherwise use its foreign exchange for, and

- provide the GOE with budgetary support generated by the sale of surplus agricultural commodities.

The United States Department of Agriculture's (USDA) Commodity Credit Corporation provided the commodities, and two GOE agencies--Principal Bank for Development and Agricultural Credit (PBDAC) and General Authority for Supply Commodities (GASC)--were to distribute and sell the commodities and deposit the sales proceeds into a Special Account. According to the program proposal, sales proceeds were then to be transferred to the General Revenue Account of the Ministry of Finance to support on-going food development activities in the Ministries of Agriculture and Irrigation.

To help plan and administer the Program, USAID/Egypt sought the assistance of the USDA's Foreign Agricultural Service (FAS). On November 29, 1991, after we had completed our audit, the Secretary of Agriculture terminated the Memorandum of Understanding under which A.I.D. had managed and implemented Section 416(b) Food

Donation Programs, and transferred program responsibilities to the USDA. This audit report is being issued to USAID/Egypt with the recommendation that USAID/Egypt transmit audit findings and associated recommendations to USDA for its use in managing the Program.

Audit Objectives

The Office of Regional Inspector General for Audit/Egypt audited the Section 416(b) Donation Food Donation Program to answer the following objectives:

- Did the Mission ensure that the Government of Egypt established criteria for measuring progress toward meeting program goals; and did the Mission prepare a logistics plan that demonstrated the adequacy of port, transportation, and storage/warehousing facilities to handle the flow of commodities without undue risk of spoilage or waste?

- Did the Mission monitor commodities to periodically ensure that they were sold at prevailing or fair market prices, and sales proceeds deposited in the Section 416(b) Special Account periodically as required by the agreement; and did the Mission monitor commodities and ensure that corn and sorghum were offered for sale to feed mills within 90 days of arrival, and butter-oil canned and sold within 90 days as required by the agreement?

Our original audit plan included a third objective. Did the Mission monitor the use of sales proceeds to confirm that they were used only for purposes authorized by the agreement and mutually agreed on by A.I.D. and the GOE? We did not address this objective because, according to USAID/Egypt officials, sales proceeds were not being used. USAID/Egypt had not executed an agreement with the GOE addressing the use of these proceeds.

In answering these objectives, we tested whether USAID/Egypt: (1) followed applicable internal control procedures, and (2) complied with certain provisions of laws, regulations, and donation agreement terms. Our tests were sufficient to provide reasonable, but not absolute, assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. Our discussion of the scope and methodology for this audit is in Appendix I, and our reports on internal controls and compliance are in Appendices III and IV, respectively.

Audit Findings

We are not able to fully answer the audit objectives because USAID/Egypt declined to provide us all the information essential for us to render a professional conclusion. For example, USAID/Egypt would not confirm that to the best of their knowledge and belief that:

- it had provided us with all the essential information,
- the information it did provide us was accurate and complete, and
- it had followed A.I.D.'s policies.

(A complete description of the essential information that USAID/Egypt would not provide or confirm is provided in the Scope and Methodology section of this report.)

Without these confirmations from USAID/Egypt, we cannot fully determine if USAID/Egypt did what it is required to do. To do so, we would in essence be stating that USAID/Egypt complied with A.I.D.'s policies and procedures when USAID/Egypt itself would not make such a statement. While we cannot state positively that USAID/Egypt followed its policies and procedures, this lack of management confirmation does not preclude us from reporting on problem areas that have come to our attention.

Did the Mission ensure that the Government of Egypt established criteria for measuring progress toward meeting program goals; and did the Mission prepare a logistics plan that demonstrated the adequacy of port, transportation, and storage/warehousing facilities to handle the flow of commodities without undue risk of spoilage or waste?

As discussed above we cannot fully answer this audit objective. Concerning the first part of this objective, the following problem area came to our attention. In preparing the Plan of Operation, USAID/Egypt had not designed a system to monitor how well the Program had been achieving its goals and objectives. Without a good plan of operation, the management of this Program is impaired.

As to the second part of this objective, records show that the Mission had met the requirement to prepare a logistics plan when on October 16, 1990 it submitted Bellmon Determination input to the State Department. Section 401(b) of PL 480 requires that the Secretary of Agriculture determine whether adequate storage facilities are available in the recipient country to prevent the spoilage or waste of the commodity. To enable the Secretary to make this determination, Section 416(b) proposals should contain data that a country has the capacity to handle, store, and distribute commodities without significant loss.

USAID/Egypt Did Not Develop Quantifiable Objectives and Measurement Indicators

To ensure that projects are properly managed and that results or outputs can be measured, missions must design systems that will provide them with needed information. A.I.D. Regulation 10 and the A.I.D. Monetization Field Manual provide criteria on the design of such a system for the Section 416(b) Food Donation Program. They specify that the Mission, in developing the Plan of Operation, should incorporate program goals, objectives, and criteria for measuring progress into the Plan of Operation. USAID/Egypt had not designed such a system apparently because they believed that this program was merely to provide budget support, and they therefore assumed they did not need to comply with A.I.D. Regulation 10 requirements. As a result, until such a system is incorporated in the Plan of Operation, USAID/Egypt will not be able to: (1) adequately direct the Government of Egypt's (GOE) efforts in meeting program objectives, (2) hold the GOE accountable for achieving progress against objectives, (3) properly evaluate the Program to assess whether adequate progress is being made in meeting the program's objectives, or (4) take timely corrective action when needed.

<u>Recommendation No. 1:</u> **We recommend that USAID/Egypt report to the Counselor, Foreign Agricultural Service, the need to develop Section 416(b) Program quantifiable objectives and indicators for measuring program progress, and include those in an amended plan of operation.**

To ensure that projects are properly managed and that results or outputs can be measured, missions must design a monitoring system that will provide them with needed management information. The criteria for the design of such a system is contained in A.I.D. Regulation 10 and the A.I.D. Monetization Field Manual. According to A.I.D. Regulation 10, paragraph 210.6(a), the Plan of Operation should clearly specify how a Section 416(b) Food Donation Program is to be conducted, and will include a description of program goals, and criteria for measuring progress toward reaching the goals. The A.I.D. Monetization Field Manual states that this Plan of Operation should include information on: (1) program goals, (2) a description of program objectives, and (3) a monitoring and evaluation plan. Further, the Mission should pay particular attention to how well the proposal: (1) defines a development problem, (2) sets realistic objectives, and (3) defines how progress will be measured.

The management system prescribed for the Section 416(b) Food Donation Program is very similar to the system A.I.D. uses in project management. In project management, A.I.D. designs bilateral projects so that each project element has certain output targets which should be achieved through the input of project resources. The combination of inputs and outputs should result in achieving a project's objective. In turn the objective should lead to the results expected under the project goal. To measure project progress, missions must:

- define the project goal,
- quantify the project's objective,
- develop benchmarks or baseline data indicating the condition at the start of the project,
- develop a management information system for gathering quantified data for measuring project results, and
- analyze the results.

Without such a measurement system, USAID/Egypt cannot adequately monitor projects. The Plan of Operation and other documentation submitted to USAID/W and subsequently approved contained no quantified objectives or measurable indicators. Also, program goals used to justify the Program were never included in the Plan of Operation. Initially the program justification was to: (1) save foreign exchange and (2) provide budget support during the Gulf Crisis. In January 1991, USAID/Egypt further justified the Program stating it was "to ensure that in view of the extraordinary demands on GOE budget resources ... key food assistance activities in the ministries of Agriculture and Irrigation will not be cut." However, these goals were never translated in terms of a monitoring system in the Plan of Operation.

This system was not developed because, according to Mission officials, this program was merely a means of providing budgetary support and saving foreign exchange, and as such it was only necessary to stipulate how these proceeds were to be collected and then only to identify the sector where they were to be used rather than to include the goals, objectives and indicators for measuring progress in the detailed Plan of Operation. We realize that any Food Donation Program will provide budgetary and foreign exchange support because the commodities received relieve the need to use existing foreign exchange for purchasing commodities, and the proceeds generated from commodity sales may be used to offset budgetary expenditures. However, the Donation Agreement that A.I.D. signed with the GOE makes no reference to budgetary support or foreign exchange, but instead states that local currency proceeds may be used for humanitarian and development activities in the Ministries of Agriculture and Irrigation consistent with providing food assistance to needy people, and that these activities will be mutually agreed upon by the GOE, the USAID Mission, and the FAS Counselor.

Because the Donation Agreement does not include goals, quantifiable objectives, and measurement indicators, the Mission cannot adequately:

- direct the GOE's efforts to meet program objectives,
- hold the GOE accountable for achieving progress against objectives,
- evaluate the Program to assess whether adequate progress is being made in meeting the Program's objectives, or
- take corrective management action as problems arise.

Not all is lost because the GOE cannot use the sales proceeds which had already amounted to about $29.9[1] million in local currency as of January 1992 until it signs a sales proceeds agreement. According to USAID/Egypt officials, a sales proceeds agreement to definitize how sale proceeds could be used was nearly complete. Disagreement with GOE concerning specific uses and usage strategy had kept the Mission from concluding this agreement earlier. We suggested that this agreement could be used to incorporate quantifiable objectives and indicators for measuring program progress included in an amended plan of operation. Because the Program had been assigned to USDA, we believe that the Mission should inform USDA of the need to consider quantified objectives and measurement indicators included in an amended plan of operation in drafting the sales proceeds agreement.

Did the Mission monitor commodities to ensure that they were sold at prevailing or fair market prices, and sales proceeds deposited in the Section 416(b) Special Account periodically as required by the agreement; and did the Mission monitor commodities and ensure that corn and sorghum were offered for sale to feed mills within 90 days of arrival, and butter-oil canned and sold within 90 days as required by the agreement?

As discussed above, we cannot fully answer this audit objective. Concerning the first part of this objective, USAID/Egypt records indicate that the price of corn and sorghum had been set at a prevailing or fair market price, but that the General Authority for Supply Commodities (GASC) reneged on the Donation Agreement to sell butter-oil at the fair market price. The Monetization Field Manual defines fair market price to be at minimum the local currency equivalent of all costs incurred prior to loading the commodity on ship for export from the United States. The Mission subsequently agreed to the GASC's lower proposed price. While the A.I.D. Monetization Field Manual suggests that A.I.D. avoid shipping commodities until a price has been negotiated, this is not a requirement. Furthermore, USAID/Egypt officials said that they had no reason at the time to doubt that GASC would not honor its commitment to sell at the fair market price. Because of the short time that elapsed between signing the agreement in Egypt and ordering the commodities in the states, we are unsure whether or not A.I.D. could have obtained a price proposal from the GOE before shipment.

[1] Based on an exchange rate of LE3.30=US$1.

USAID/Egypt records showed that proceeds from sales of corn and sorghum were being deposited to the Special Account. As of January 9, 1992, GASC had sold a small quantity of butter-oil while PBDAC had sold a significant quantity of corn and a small quantity of sorghum.

Commodity	Butter-oil	Sorghum	Corn
Metric Tons Donated	5,285.0	100,000.0	300,000.0
Metric Tons Sold	599.7	6,120.9	193,870.8
Percent Sold	11.3	6.1	64.6

As for the second part of this objective, PBDAC records showed that while corn and sorghum were offered for sale within 90 days of their July and August 1991 arrival, butter-oil was not being marketed quickly--within 90 days of arrival--because of difficulties in establishing a sales price. USAID/Egypt subsequently gave the GOE a waiver on butter-oil arriving in August 1991 by extending this 90 day period to 180 days.

Management Comments and Our Evaluation

In their response to our draft report, USAID/Egypt has taken exception to the Inspector General's position that management's refusal to issue a representation letter constitutes a scope limitation to the audit and precludes us from issuing an unqualified opinion. Our response to the Mission's comments on this matter is contained in Appendix V.

The Mission advises that on March 15, 1991 it had (1) officially transferred all program responsibility for the FY 1991 Section 416(b) Food Donation Program to the Counselor, FAS, (2) provided that office a copy of our draft report, and (3) pointed out to FAS the need to develop quantifiable objectives and indicators for measuring program progress in accordance with our recommendation. The Mission makes clear that FAS is not governed by A.I.D. Regulation 10, and that it will be up to the FAS to determine whether such objectives and indicators should be developed.

The Mission maintains that the Section 416(b) program guidance is vague, and questions whether it applies to a monetization program such as this. They insist that both Regulation 10 and the Monetization Field Manual are designed for general budgetary support, and that this Program was justified on the basis that it would help relieve balance of payments and budgetary pressures resulting from the Gulf Crisis.

Of course, any Food Donation Program will provide budgetary and foreign exchange support because the commodities received relieve the need to use existing foreign exchange for purchasing commodities, and the proceeds generated from commodity sales may be used to offset budgetary expenditures. However, the Donation Agreement that A.I.D. signed with the GOE makes no reference to budgetary support or foreign exchange, but instead states that local currency proceeds may be used for humanitarian and development activities in the Ministries of Agriculture and Irrigation consistent with providing food assistance to needy people, and that these activities will be mutually agreed upon by the GOE, the USAID Mission, and the FAS Counselor.

The Monetization Field Manual, which the Mission states is directed primarily at Private Voluntary Organization operated-direct feeding programs, is also specifically directed toward monetization programs. Further, it prescribes that AID Regulation 10 provisions also apply to monetization programs.

At the beginning of our audit, USAID/Egypt officials advised us that a sales proceeds agreement would be executed addressing the specific uses of sales proceeds. We were not provided a final copy of this proposed agreement and so have no assurance that it contains quantifiable objectives and indicators for measuring program progress or that it addresses the specfic uses of sales proceeds. Also, we have no assurance that a copy was provided to the FAS Counselor.

Since the Mission has passed our recommendation on to the FAS Counselor for his consideration, we consider this matter closed as we no longer have jurisdiction on actions he might take. We will send a copy of this final report to the Inspector General, USDA.

The full text of the Mission's response is included as Appendix II.

Area Needing Further Study

During our visits to ten storage facilities containing corn and/or sorghum, we observed that six had significant quantities of grain exposed to potential damage from winter rains.

- Sorghum was mostly uncovered by tarps in two of the three facilities visited in the greater Cairo area (Giza governorate).

- Corn was partially uncovered by tarps in five of the facilities visited and largely uncovered in one of the facilities.

In addition to potential damage from rain, there was a potential for theft because two storage facilities in the Beheira and Dakahlia Governorates had gaping holes in their perimeter.

We recognize that GOE is responsible for the safeguarding of A.I.D. funded commodities after arrival, and that the Mission's monitoring role for commodities in storage is not specified under A.I.D. Regulation 10. However, we believe that the Mission could have a positive influence in getting corrective action if it were to communicate its concern about possible rain damage to PBDAC. Accordingly, we brought these matters to USAID/Egypt's attention on November 10, 1991 so that they might prod PBDAC to take corrective action, and thereby avoid any loss or damage to grain which would reduce sales proceeds. USAID/Egypt brought this matter to PBDAC's attention, and in early February 1992 PBDAC replied that all storage facilities were now covered, and that facilities with gaping holes were protected by security guards.

Grain Mounds Partially Covered by Tarps
Beheira Governorate--October 22, 1991

Grain Mounds Not Covered by Tarps
Beheira Governorate--October 22, 1991

Storage Facility With an Adequate Perimeter Enclosure
Dakahlia Governorate--October 17, 1991

Storage Facility With a Large Hole in The Perimeter Enclosure
Beheira Governorate--October 22, 1991

SCOPE AND METHODOLOGY

Scope

We followed generally accepted government auditing standards except that USAID/Egypt's management would not provide us with a representation letter confirming information essential to fully answer the audit objectives. Management's refusal to make such representation constitutes a limitation on the scope of the audit.

Government Auditing Standards require auditors to obtain representation letters when the auditors deem them useful. The Office of the Inspector General has deemed that representation letters are necessary evidence to support potentially positive findings. We requested that the Director, USAID/Egypt furnish written representation with regards to this audit assignment. The Director, USAID/Egypt has declined to provide written representation until (1) a current unfair labor practice filed by the American Foreign Service Association--apparently arising out of the Inspector General's initiation of the letter of representation policy--is resolved, and (2) USAID/W furnishes final guidelines to the field concerning the letter of representation policy.

The information that USAID/Egypt managers would not confirm <u>to the best of their knowledge and belief</u> follows:

1. whether they are responsible for the internal control system, compliance with applicable laws and regulations, and the fairness and accuracy of accounting and management information for the organization under audit;

2. whether they have provided us with all the financial and management information associated with the activity or function under audit;

3. whether they know of any irregularities in the activity;

4. whether they know of any material instances where financial or management information has not been properly and accurately recorded and reported;

5. whether they are aware of any instances of noncompliance with A.I.D. policies and procedures or violations of laws and regulations;

6. whether they have complied with contractual agreements; and

7. whether they know of any events subsequent to the period under audit that could affect the above representations.

The answers to the above types of questions are so fundamental to the basic concepts of auditing that it is not possible to render a positive opinion without them. Thus, if managers will not answer these basic questions and will not confirm their answers in writing through a representation letter, then we cannot risk giving a positive opinion. While we cannot render a positive conclusion without such representations, this lack of a management confirmation does not preclude us from reporting on problem areas that came to our attention and we have done so.

The audit covered the period May 21, 1991 through October 1991. As criteria, we used Section 416(b) of the Agricultural Act of 1949, and the policies and procedures set forth in A.I.D. Regulation 10 and in the Donation Agreement. We audited all three commodities--corn, sorghum and butter-oil--donated to the GOE and collectively valued at about $55 million.

Our audit was conducted from August 26, 1991 to October 31, 1991 at USAID/Egypt's Program Development and Support office; the FAS office; GASC headquarters; PBDAC headquarters and branch banks; 10 storage facilities in three of the 23 governorates receiving corn, namely Dakahlia, Giza, and Beheira; and at one of the 5 governorates receiving sorghum -- Giza. Our work included reviewing the proposal justifying the Program; the Donation Agreement and related Plan of Operation; Bellmon Determination input; USAID/Egypt correspondence with PBDAC and GASC evidencing consultation over fair market price; bank deposit slips; sales receipts and sales summaries at PBDAC banks; receiving, distribution and inventory reports at each of the 3 governorates visited; and a proposed sales proceeds agreement.

We verified whether the Donation Agreement contained measurement criteria; assessed the adequacy of the Bellmon Determination input; determined whether sales occurred within the 90 day period required by the Donation Agreement; queried USAID/Egypt officials as to how they planned to verify that sales proceeds were being deposited accurately and used for purposes authorized by the Donation Agreement; verified the accuracy and timeliness of sales proceeds deposited; and examined the safeguarding of commodities by observing how grain was secured and protected from rain.

We audited 300,000 metric tons of corn, 100,000 metric tons of sorghum and 5,785 metric tons of butter-oil that was donated to the GOE, and conducted tests at 3 governorates receiving 75,123 metric tons of corn (or about 25 percent of the total donated), and one governorate receiving 22,858 metric tons of sorghum (or about 23 percent of the total donated). These governorates were selected on the basis of high quantity of corn received and large quantity on hand. Our tests of corn covered 10 storage facilities receiving 35,639 metric tons, or about 47 percent of the quantity distributed to the 3 governorates and 12 percent of the quantity donated to Egypt. Our tests of sorghum covered 3 facilities receiving 7,562 metric tons or about 33 percent of the quantity distributed to the governorate and 7 percent of the quantity donated to Egypt. We selected storage facilities on the basis of large quantities on hand, and proximity to local PBDAC branch banks. We conducted no tests of butter-oil because it was not being sold at the time of our audit when the Mission was having great difficulty in reaching an agreeable price with the GASC.

Methodology

Audit Objective One

To address audit objective one, we: (1) examined the Program proposal, Donation Agreement and related Plan of Operation and interviewed program officials to identify applicable goals, objectives and indicators for measuring progress; (2) reviewed A.I.D. Regulation 10, the A.I.D. Monetization Field Manual, and A.I.D. Handbook 3 to identify management system elements appropriate for managing the Program; (3) assessed the impact of failure to submit a Plan of Operation having appropriate management system elements; and (4) reviewed the Mission's Bellmon Determination input to determine whether the Mission met the requirement to prepare a logistics plan.

Audit Objective Two

To address audit objective two, we obtained and examined documentation showing how sales prices of corn, sorghum and butter-oil were established, determined whether USAID/Egypt consulted with the FAS Counselor as required in setting a sales price, and compared negotiated prices against criteria in the A.I.D. Monetization Field Manual to determine whether prices were within the fair market price range. Becausė there was no central source for detailed sales data, we randomly tested sales records at local PBDAC banks in 3 governorates for sales by 10 selected storage facilities to ascertain whether sales proceeds were deposited. We also determined how USAID/Egypt verified that sales proceeds were deposited, and obtained documentation showing that this verification had occurred.

To determine whether corn and sorghum were safeguarded, we examined 10 selected storage facilities and observed how grain was secured and protected from rain. To determine whether corn and sorghum were offered for sale within 90 days of arrival and butter-oil retailed within 90 days of arrival, we compared commodity arrival documentation with sales documents. We did not attempt to determine if butter-oil was being safeguarded because we did not consider it to be highly vulnerable to loss.

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UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

MEMORANDUM

MAR 17 1992

TO: Philippe Darcy, RIG/A/C

FROM: George Wachtenheim, D/DIR

SUBJECT: Draft Audit Report on Audit of Section 416(b) Food Donation Program

Discussed below are the general Mission comments on the requirement for a management letter and the actions the Mission has taken to close the audit recommendation. We request that the General Mission Comments be published in the Mission's Comments Section of the final Audit Report. Thank you.

GENERAL MISSION COMMENTS

USAID/Egypt takes exception to the IG position that Management's refusal to issue a representation letter constitutes a scope limitation to the audit and precludes the auditors from issuing an unqualified opinion. A representation letter is not required under current professional governmental audit standards. The auditors, under generally accepted governmental auditing standards are able to design an audit plan to provide themselves reasonable assurance to answer each and every audit objective. The IG "Policy" in effect states that reasonable assurance can only be obtained through a representation letter. The IG policy imposes an artificial scope limitation and attempts to intimidate management into providing testimonial evidence. Testimony obtained through intimidation is contrary to the precepts of judging the competence of evidential matter contained in the GAO's audit field work standards. We believe the auditors have at their disposal, other valid, objective and reliable means of obtaining and verifying evidential matter to answer the types of questions, listed on page 20 and 21 of this report, which they deem fundamental to the basic concepts of auditing.

In 1988, the GAO issued the "Yellow Book" or new Governmental Auditing Standards. While representation letters are required evidential matter for financial audits, the GAO standards for performance audits states that "Auditors should, when they deem it useful, obtain from officials of the audited entity written representations concerning the relevance and competence of the evidence they obtain." (emphasis added) The IG however, has enacted a Policy which automatically precludes the auditor from rendering a professional opinion as to whether a audit objective has been met, when a representation letter is not provided by management. It is indeed unfortunate that an IG Policy negates the independence and professionalism of the individual auditor who is required under the fifth field work standard for performance audits to design and plan his/her work to obtain sufficient, competent and relevant evidence to afford a reasonable basis for his/her judgements and conclusions with respect to the audit objective. The policy challenges the validity of the hundreds of previous audit reports issued by the IG without a representation letter being provided by management.

Management's reluctance to issue a representation letter stems from the very nature of performance audits in AID. It is not Management's report that is being audited. The scope of the audit is broad and subject to change. The normative criteria for each objective is unknown to Management and/or subject to change. The activities under audit often have lives of over ten years with different cognizant managers at various periods of time.

These major differences vis-a-vis financial audits make it difficult for AID Managers to provide representation letters. During the course of this audit, USAID has provided the auditors with documents pertaining to its Internal Control Systems, made available all its files, and USAID personnel have spent countless hours cooperating with the auditors answering questions and being subject to interviews. Given the types of evidence presented and available to the auditors throughout the audit, and the various tests to which this evidence can be subjected in determining its sufficiency, relevance and competency, we believe it spurious to qualify an opinion based on a policy, which denigrates Management's good faith efforts as well as the professional judgement of the auditor in planning and conducting his/her audit work.

Recommendation No. 1:

We recommend that USAID/Egypt report to the Counselor, Foreign Agricultural Service, the need to develop Section 416(b) Program quantifiable objectives and indicatiors for measuring program progress, and include those in an amended plan of operations.

Mission's Response:

With respect to Recommendation No. 1, the USAID/Egypt, in the attached letter dated March, 1992, reported to the Counselor FAS, the RIG/A's conclusion that quantifiable objectives and indicators should be developed for the Section 416 program. However, the FAS is not governed by A.I.D. Regulation 10 and it will be up to the FAS to determine whether this is appropriate.

Even though responsibility for Section 416 programs has been shifted from USAID to USDA as of December 1, 1991, basically in the mid-stream of this current activity, we would like to call attention to what we believe is the ambiguity of A.I.D. Regulation 10 and the A.I.D. Monetization Field Manual with respect to Section 416 programs which are designed for general budget support as opposed to PVO-operated, direct feeding programs.

Ever since the beginning of this program, the Mission has made clear, in its documentation justifying the program, that its primary rationale was to provide Section 416 commodities to help relieve balance of payments pressures and to provide local currency resources to relieve extraordinary pressures on the budget. While we agree that it is always important to have a clear set of objectives, whatever activity we are supporting, we question whether the guidance in Regulation 10, pertaining to objectives and indicators is appropriate for a program of this nature, as opposed to one which sees monetization occurring under PVO direct feeding programs. In this respect, the Missions's Plan of Operation was reviewed by the interagency Development Assistance Committee and approved without comment on the lack of these items.

There is an inference in the audit report that the absence of stated objectives and indicators is somehow a threat to the program. The statement on page 12 of the audit that "not all is lost" because the GOE cannot use the proceeds until a sales proceeds agreement is signed is gratuitous. As the audit report itself says, the specific use of the sales proceeds is defined in the Sales Proceeds Agreement, which was not signed before the transfer of responsibility to FAS for very good reasons. Thus, there never was any risk that the proceeds would be used for purposes other than intended; i.e., for budget support which, by its very nature, supports general budgets or classes of activities in general budgets.

Theoretically, objectives and indicators could be integrated into the Sales Proceeds Agreement rather than the Plan of Operation. However, we still question the purpose of traditional indicators of performance when the real measure of performance under a budget support program is documentary evidence that the budgets have received those funds. The draft Sales Proceeds Agreement required such documentary evidence.

Based on the above, the Mission requests that this recommendation be closed upon issuance of the final audit report.

Att: a/s

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

March 15, 1992

Mr. Frank Lee
Agricultural Counselor
United States Department of Agriculture
Foreign Agricultural Service
American Embassy
Cairo

Ref: (A) State 409669, dated December 18, 1991
(B) State 417507, dated December 25, 1991

Dear Frank,

This letter is to officially turn over all program responsibility for the FY 1991 Section 416(b) Food Donation Program to your office. The cables referenced above provide the authority for the turn-over, stating that "effective immediately, all Section 416(b) program responsibilities belong to USDA and their country or regional agricultural attaches, as appropriate."

We have discussed this change-over with you and Mr. Ronald Verdonk, the Agricultural Attache, on a number of occasions. In addition, on February 2, 1992, under Cairo 01903, we officially informed the U.S. Department of Agriculture in Washington, DC that, "USAID/Cairo has terminated program oversight and administrative management over the FY 1991 416(b) Food Donation (Monetization) Program." USAID/Cairo is no longer responsible for implementation of the Agricultural Commodity Foreign Donation Agreement of May 21, 1991, negotiation of the Sales Proceeds Agreement or for implementation of the Section 416(b) program in Egypt. We have already informed the Ministry of International Cooperation of this turn-over.

Presently, over LE 121 million has been generated from the monetization of the Section 416(b) commodities and are available to be programmed once you negotiate your Sales Proceeds Agreement. We have estimated that approximately LE 200 million would be available from the monetization and sale of all of the the Section 416(b) commodities. In this regard, and as of February 20, 1992, there is a total of LE 116,417,951.56 on deposit in account number 912/57/1 in the

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National Bank of Egypt from the monetization by PBDAC of 226,439 MT of yellow corn and 10,579 MT of sorghum. In addition, there is approximately LE 5,000,000 available in the National Bank of Egypt from the monetization by the Ministry of Supply of approximately 600 MT of butter oil.

As you are aware, the AID Regional Inspector General's Office recently completed their audit of the Section 416(b) Program. The RIG recommended that we transmit audit findings and associated recommendations to you for use in managing the Program and to inform you "of the need to consider quantified objectives and measurement indicators in an amended plan of operation in drafting the sales proceeds agreement." I am therefore attaching a copy of the draft audit report for your use.

I would like to take the opportunity at this time to state that we certainly appreciate the support and assistance that you and Ron have provided to us in carrying out the Section 416(b) program over the summer and fall of 1991. We would be pleased to reciprocate if at any time you may need assistance.

Thanks again.

Sincerely yours,

Christopher D. Crowley
Associate Director
Program Development and
Support Directorate

Attachment a/s

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REPORT ON INTERNAL CONTROLS

This section of the report provides a summary of our assessment of internal controls for the audit objectives.

Scope of Our Internal Control Assessment

We have audited USAID/Egypt's management of the Section 416(b) Food Donation Program for the period May 21, 1991 through October 1991. We conducted our audit in accordance with generally accepted government auditing standards, except that management would not provide us with a representation letter confirming, among other things, its responsibility for the internal controls related to the audit objectives or confirming whether or not there were any instances of noncompliance with A.I.D. policies and procedures or whether or not it had provided us with all the information related to this Program. These standards require that we plan and perform the audit to fairly, objectively, and reliably answer the objectives of the audit. Those standards also require that we: (1) assess the applicable internal controls when necessary to satisfy the audit objectives, and (2) report on controls assessed, the scope of our work, and any significant weaknesses found during the audit.

Management's refusal to make such representations, constitutes a limitation on the scope of the audit and is sufficient to preclude an unqualified conclusion on the reliability of the internal controls related to the audit objectives. (A complete description of the representations that USAID/Egypt would not make is provided in the Scope and Methodology section of this report).

We limited our assessment of internal controls to those controls applicable to the audit's objectives, and not to provide assurance on the auditee's overall internal control structure.

Significant internal control policies and procedures applicable to each audit objective were categorized. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation--and we assessed control risk. We have reported on these categories as well as any significant weaknesses under the conclusions for each audit objective.

General Background on Internal Controls

Under the Federal Managers' Financial Integrity Act and the Office of Management and Budget's implementing policies, A.I.D.'s management is responsible for establishing and maintaining adequate internal controls. Also, the General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining internal controls.

The objectives of internal controls and procedures for Federal foreign assistance are to provide management with reasonable--but not absolute--assurance that: resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Predicting whether a system will work in the future is risky given that conditions may change or the system itself may not be properly administered.

Conclusions for Audit Objective One

This audit objective relates to whether the Mission: (1) ensured that the GOE established criteria for measuring progress toward meeting program goals, and (2) prepared a logistics plan that demonstrated the adequacy of port, transportation, and storage/warehousing facilities to handle the flow of commodities without undue risk of spoilage or waste. To answer the two parts of this objective, we reviewed A.I.D. Regulation 10 and the A.I.D. Monetization Field Manual which prescribes management system elements that should be present in the Donation Agreement and discusses preparation of a logistics plan.

According to this manual, the Mission should (a) pay particular attention to how well the program proposal defines the development problem, sets realistic objectives, and defines how progress will be measured, and (b) include program goals, a description of program objectives, and a monitoring and evaluation plan in the Agreement. Also, Section 416(b) proposals should contain data that a country had the capacity to handle, store, and distribute commodities without significant loss.

We found that A.I.D. had not designed a system to monitor how well the Program was achieving its goals and objectives. More specifically the Program, as approved, lacks key management system elements--quantifiable objectives and measurement indicators needed for adequately managing the Program. As a result USAID/Egypt may well have difficulty in: (1) adequately directing the cooperating sponsor's efforts in meeting program objectives, (2) holding the cooperating sponsor accountable for achieving progress against objectives, (3) properly evaluating the Program to assess whether sufficient progress is being made in meeting the program's objectives, or (4) generating corrective management action based on any evaluation conducted. We are not, however, able to conclude on the reliability of these controls, as management would not confirm in a representation letter essential information related to these controls.

Although we identified weaknesses in the internal controls used to manage this one-time program, we do not consider these weaknesses to be material enough to be reported as material weaknesses by the Mission under the Federal Manager's Financial Integrity Act.

Conclusions for Audit Objective Two

This audit objective relates to whether the Mission ensured that: (1) commodities were sold at prevailing or fair market prices and sales proceeds were deposited in the Special Account periodically as required by the agreement, and (2) corn and sorghum were offered for sale to feed mills within 90 days of arrival and butter-oil was canned and sold within 90 days, as required by the agreement. To answer the two parts of this objective, we reviewed guidance contained in the A.I.D. Monetization Field Manual.

According to this manual, the GOE should attempt to set a sales price which represents fair market value, and is at a minimum, equal to the local currency equivalent of all costs incurred prior to loading the commodity on ship for export from the United States. There was no clarification as to when commodities should be offered or sold, beyond what was stated in the donation agreement. We are not, however, able to conclude on the reliability of these controls, as USAID/Egypt management would not confirm in a representation letter essential information related to these controls.

Because of this lack of management information, we cannot therefore state positively that the internal controls relative to this audit objective are effective and can be relied on. However, based on the information that USAID/Egypt did provide to us and the tests that we were able to perform, we only can report that no significant internal control weaknesses came to our attention, other than USAID/Egypt's inability to confirm essential information about its own internal controls.

REPORT ON COMPLIANCE

This section summarizes our conclusions on compliance with applicable laws and regulations.

Scope of Our Compliance Assessment

We have audited USAID/Egypt's compliance with certain provisions of Section 416(b) of the Agricultural Act of 1949, A.I.D. Regulation 10, and the Donation Agreement during the period May 21, 1991 through October 1991. We conducted our audit in accordance with generally accepted government auditing standards, except that management would not provide us with a representation letter confirming to the best of their knowledge and belief: (1) their responsibility for compliance with applicable laws and regulations, (2) whether or not there were any irregularities involving management or employees, (3) whether or not there were any instances of violations or possible violations of laws and regulations. (A complete description of the representations that USAID/Egypt would not make is provided in the Scope and Methodology section of this report).

Management's refusal to make such representations, constitutes a limitation on the scope of the audit and is sufficient to preclude us from designing our audit to provide reasonable assurance of detecting abuse and illegal acts and from giving an unqualified conclusion on compliance with A.I.D. Regulation 10 and the Donation Agreement.

Generally accepted government auditing standards require that we plan and perform the audit to fairly, objectively, and reliably answer the objective of the audit. Those standards also require that we:

- assess compliance with applicable requirements of laws, regulations and pertinent agreements when necessary to satisfy the audit objective, and

- report all significant instances of noncompliance and abuse, and all indicators or instances of illegal acts found in connection with the audit.

We tested USAID/Egypt's compliance with the Agricultural Act of 1949, A.I.D. Regulation 10, and the Donation Agreement, as they could affect our audit objectives. However, our objective was not to provide an opinion on USAID/Egypt's overall compliance with such provisions.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions contained in statutes, regulations, contracts, grants and binding policies and procedures governing an organizations conduct. Noncompliance constitutes of an illegal act when there is a failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance and criminal acts. Not following internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition of noncompliance and is included in our report on internal controls. Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations.

Conclusions on Compliance

We reviewed USAID/Egypt's compliance with Section 416(b) of the Agricultural Act of 1949, A.I.D. Regulation 10, and the Donation Agreement. However, as management would not confirm in a representation letter essential information related to such compliance, we cannot state positively that USAID/Egypt has complied. However, based on the information that USAID/Egypt did provide us and the tests that we were able to perform, we can report that the only irregularity or instance of violation of such applicable laws and regulations that came to our attention was that USAID/Egypt did not incorporate a description of program goals and criteria for measuring progress toward reaching the goals into the Plan of Operation as required by A.I.D. Regulation 10.

RIG/A/CAIRO COMMENTS ON USAID/EGYPT PERCEPTIONS ABOUT PROFESSIONAL AUDIT STANDARDS

In commenting on USAID/Egypt management's refusal to provide requested written representations, the Mission said that: *"USAID/Egypt takes exception to the IG position that Management's refusal to issue a representation letter constitutes a scope limitation to the audit and precludes the auditors from issuing an unqualified opinion."* The Mission then proceeded to support this position by detailing a number of management's perceptions on what generally accepted government auditing standards require. Because these perceptions are causing interference with the scope of our audit work and the auditors' application of auditing procedures deemed necessary for our audit objectives, the following comments address each of those perceptions.

MISSION PERCEPTION: *"A representation letter is not required under current professional governmental audit standards."*

RIG COMMENTS: The Mission does not understand the requirements of generally accepted government auditing standards for representation letters. In reality, generally accepted government auditing standards require representation letters for all financial audits and require[1] that these letters be employed for performance audits "when deemed useful" by the auditors. Therefore, a correct understanding of the standards would be: **A representation letter is required under generally accepted government auditing standards for a financial audit and, when deemed useful by the auditors, is required under generally accepted government auditing standards for a performance audit.**

Representation letters are required by the Statements on Auditing Standards (SAS No. 19) of the American Institute of Certified Public Accountants (AICPA) for all financial audits performed in accordance with generally accepted auditing standards and have been used for years for financial audits both in the private sector and in the Government. The AICPA standards have been fully incorporated into generally accepted government auditing standards (Yellow Book) for financial audits, and the concepts embodied in those standards establish the foundation upon

1. Although the Yellow Book uses the term "should", because of Mission management's misunderstandings we are avoiding the technical terminology by inserting "require". According to the Yellow Book, "When the term 'should' is used to describe the auditor's and/or audit organization's responsibility, this means that the standards that are applicable to the work and necessary to satisfy an audit objective are to be followed. Departures from applicable standards must be disclosed in the audit report." (Source: Yellow Book, page G-11)

which generally accepted government auditing standards for performance audits have been built.[2]

For performance audits, for example, representation letters are required, according to generally accepted government auditing standards, when deemed useful in answering an audit objective. The A.I.D. OIG (as well as several other OIGs) has deemed representation letters useful in answering the audit objectives now being established under our new systems audit approach.

The reason for this determination resides in the types of audit objectives currently being pursued by the OIG. According to generally accepted government auditing standards, "All audits begin with objectives and those objectives determine the type of audit to be conducted and the audit standards to be followed [Emphasis added]." The OIG has established new policies which require auditors to establish audit objectives which can result in the development of positive findings--a change from the "deficiency" auditing of the past where we mainly audited and reported on weaknesses and problems. Thus OIG audit reports can now provide positive "attestations"[3] on A.I.D.'s performance. It is these new types of audit objectives which have, in effect, determined that the audit standard for representation letters be followed in all of our performance audits which began on or after July 1, 1991.

These new policies and these new types of objectives are based, in part, upon meeting a need expressed by A.I.D. management that A.I.D/OIG audit reports should report on the positive aspects of A.I.D's performance as well as the negative aspects. Therefore, to meet

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2. Source: Auditing Standards Established by the GAO--Their Meaning and Significance for CPA's, prepared by the Committee on Relations with the General Accounting Office, American Institute of Certified Public Accountants, 1973. "The GAO standards follow the same general organization as generally accepted auditing standards of the AICPA...The members of this Committee agree with the philosophy and objectives advocated by the GAO in its standards and believe that the GAO's broadened definition of auditing is a logical and worthwhile continuation of the evolution and growth of the auditing discipline."

3. Source of terminology: Codification of Statements on Auditing Standards, AT Section 100, Attestation Standards, AICPA, 1990--"An attest engagement is one in which a practitioner is engaged to issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party...when a practitioner undertakes an attest engagement for the benefit of a government body or agency and agrees to follow specified government standards, guides, procedures, statutes, rules, and regulations, the practitioner is obliged to follow this section and the applicable authoritative interpretive standards as well as those government requirements...An assertion is any declaration, or set of declarations taken as a whole, by a party responsible for it."

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A.I.D/management's need by planning[4] and performing such attestation-type work, the OIG has determined that the documentary evidence of management's representations/assertions,[5] which is required under AICPA standards for attestations in financial audits, is also necessary for attestations in performance audits.[6]

MISSION PERCEPTION: *"The auditors, under generally accepted governmental auditing standards are able to design an audit plan to provide themselves reasonable assurance to answer each and every audit objective. The IG "Policy" in effect states that reasonable assurance can only be obtained through a representation letter. The IG policy imposes an artificial scope limitation and attempts to intimidate management into providing testimonial evidence. Testimony obtained through intimidation is contrary to the precepts of judging the competence of evidential matter contained in the GAO's audit field work standards."*

RIG COMMENTS: The Mission does not understand (1) generally accepted government auditing standards for planning an audit, (2) the purpose of OIG policy, (3) the difference between testimonial evidence and documentary evidence, and (4) generally accepted government auditing standards for due professional care.

According to generally accepted government auditing standards for planning an audit, **"The methodology selected needs to provide evidence that will achieve the objectives of the audit."** If an audit objective only calls for auditing and reporting on weakness and problems, the OIG believes that the methodology for obtaining evidence to achieve this objective may not have to include an audit procedure for obtaining a management representation letter. However, if the audit objective calls for the auditors to develop and report positive findings--providing attestations upon which A.I.D. management, the U.S. Congress, and others can rely--the OIG has determined that the methodology for obtaining evidence to achieve this objective must include an audit procedure for obtaining a management representation letter to provide the additional documentary evidence and assurances called for by these attestations. For example,

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4. Source: Codification of Statements on Auditing Standards, AU Section 9326.03, AICPA, 1990--"the auditor develops specific audit objectives in light of assertions by management..."

5. Source: SAS No. 19.

6. Source of OIG policy determination: Codification of Statements on Auditing Standards, AICPA, 1990, page 763--"for years, attest services generally were limited to expressing a positive opinion on historical financial statements on the basis of an audit in accordance with generally accepted auditing standards (GAAS). However, certified public accountants increasingly have requested to provide, and have been providing, assurance on representations other than historical financial statements and in forms other than the positive opinion. In responding to these needs. certified public accountants have been able to generally apply the basic concepts underlying GAAS to these attest services."

a common misconception in both the private sector and Government has been that the auditors are responsible for the internal controls they audit.[7] To avoid such misconceptions when performing attestation-type work and to help protect the auditor from liability, the auditor is required to obtain written representations from management.[8]

OIG policy is specifically designed not to intimidate management but to implement generally accepted government auditing standards which, by law, we are required to follow. Under the Inspector General Act, the OIG is specifically required to provide policy direction for audits. Furthermore, under standards established by the President's Council on Integrity and Efficiency, the OIG is also required to establish audit policies which will ensure a consistent and proper application of auditing standards to the work of the OIG. Recently, under the direction of the President's Council on Integrity and Efficiency, the A.I.D. OIG policies, which include the policy on management representation letters, were reviewed by another OIG and were determined to be in accordance with standards.

The OIG policy on management representation letters is not directed at obtaining testimonial evidence but at confirming oral representations given to the auditors, indicating and documenting the continuing appropriateness of those representations, and reducing the possibility of misunderstanding concerning the matters that are the subject of the representations.

Our policies do require the auditor to obtain testimonial evidence to, among other things, ensure that the audit findings and conclusions are placed in proper perspective. Testimonial evidence is and always has been an essential part of any audit and, generally, the A.I.D. OIG has faced few problems in obtaining testimonial evidence. However, since testimonial evidence is the weakest form of evidence, our policies and generally accepted government auditing standards require the auditor to obtain other forms of evidence to sufficiently support the auditor's

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7. Source: James F. Antonio, Chairman of the Governmental Accounting Standards Board, William A. Broadus, Jr., Lead of Author of the 1988 revisions to the Yellow Book, General Accounting Office, Ronald J. Points, Price Waterhouse, during presentations and question and answer periods, during AICPA 6th Annual National Governmental Accounting and Auditing Update Conference, August 28-29, 1989, in explaining implementation of the "Expectation GAP" SASs, Findings and Recommendations of the Treadway commission, Reasons for revisions to Yellow Book, and reasons for SAS 55.

8. Source: Codification of Statements on Auditing Standards, AICPA, 1990, AT Section 100.04-- "The practitioner who has assembled or assisted in assembling an assertion should not claim to be the asserter if the assertion is materially dependent on the actions, plans, or assumptions of some other individual or group. In such a situation, that individual or group is the "asserter", and the practitioner will be viewed as an attester if a conclusion about the reliability of the assertion is expressed.

conclusions. For positive findings, the OIG policy on management representation letters is meant to ensure that the auditor obtains the additional documentary evidence required to support the auditor's attestations on the positive performance of management.

The auditor's efforts to advise management of potential scope impairments is **not** a matter of obtaining evidence through intimidation but a matter of the auditors following the standard for due professional care. The Yellow Book reference to intimidation is directed at cautioning auditors about situations where the presence of management, peers, or other circumstances could intimidate the interviewee from speaking freely. Under generally accepted government auditing standards for due professional care, the auditors are required to attempt to remove any impairment and, if not possible, disclose the impairment in the scope section of the report and the known effect it had on the results of the audit. The auditors' efforts to inform Mission management of our standards and of the impact from management's refusal to provide a management representation letter has been a matter of the auditors attempting to remove impairments as required by generally accepted government auditing standards.

MISSION PERCEPTION: *"We believe the auditors have at their disposal, other valid, objective and reliable means of obtaining and verifying evidential matter to answer the types of questions, listed [in the scope section] of this report, which they deem fundamental to the basic concepts of auditing."*

RIG COMMENTS: Although A.I.D. management is entitled to its belief, generally accepted government auditing standards assign to the auditor the responsibility for selecting and applying those auditing procedures which the auditor considers necessary under the circumstances. Auditors do select and apply a number of valid, objective, and reliable means of obtaining and verifying evidential matter. To draw conclusions on and attest to the positive aspects of Mission management's performance is where additional documentary evidence--a management representation letter--is needed.

For example, one of the written representations that we asked Mission management to provide was that, to the best of their knowledge and belief, they had provided us with all the financial and management information associated with USAID/Egypt's Section 416(b) Food Donation Program. Although Mission management refused to provide us this written representation, in responding to the draft of this report Mission management did provide the written representation that *"USAID has provided the auditors with documents pertaining to its Internal Control Systems, made available all its files, and USAID personnel have spent countless hours cooperating with the auditors answering questions and being interviewed."*

Although this written representation came close to what we requested, Mission management did not provide the requested explicit confirmation. Without this confirmation, we lack documentary evidence to reasonably support that (1) no essential documents pertaining to the internal control systems were withheld from us, (2) the files were not purged for the purposes of this audit, and

(3) Mission management did not withhold any essential testimonial evidence.[9] As a result, we are unable to rely on the documents, files, and testimonial evidence to attest that, among other things, the Mission followed A.I.D. policies and procedures. The best that we can do is to report that, based on the evidence that the Mission did provide to us, no problems came to our attention, except for the problems noted in this report.

MISSION PERCEPTION: *"In 1988, the GAO issued the "Yellow Book" or new Governmental Auditing Standards. While representation letters are required evidential matter for financial audits, the GAO standards for performance audits states that "Auditors should, when they deem it useful, obtain from officials of the audited entity written representations concerning the relevance and competence of the evidence they obtain" (emphasis added) The IG however, has enacted a Policy which automatically precludes the auditor from rendering a professional opinion as to whether an audit objective has been met, when a representation letter is not provided by management. It is indeed unfortunate that an IG Policy negates the independence and professionalism of the individual auditor who is required under the fifth field work standard for performance audits to design and plan his/her work to obtain sufficient, competent and relevant evidence to afford a reasonable basis for his/her judgements and conclusions with respect to the audit objective. This policy challenges the validity of the hundreds of previous audit reports issued by the IG without a representation letter being provided by management.*

RIG COMMENTS: As previously stated, the Mission does not understand what is required under generally accepted government auditing standards and how those standards relate to AICPA standards with respect to management representation letters. In addition, the Mission does not understand (1) the use of the term "auditor" in the auditing profession, (2) generally accepted government auditing standards for independence, and (3) the evolutionary nature of the auditing profession and its standards.

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9. To avoid additional misunderstandings, a few words of clarification are needed. Under generally accepted government auditing standards, the auditor is required to maintain an attitude of professional skepticism. This means neither assuming that management is dishonest nor assuming unquestioned honesty. Rather, the auditor recognizes that conditions observed and evidential matter obtained need to be objectively evaluated in answering the audit objective. (Source: Codification of Statements on Auditing Standards, AICPA, 1990, Section, AU 316.16)

By not knowing how the auditing profession[10] uses the term "auditor", Mission management has further misinterpreted generally accepted government auditing standards for performance audits. According to page G-1 of the Yellow Book, "auditor" refers to the auditor as well as the audit organization unless otherwise indicated. Thus, in the case of audit planning (the first field work standard), evidence (the fifth field work standard), or any of the other standards, the requirements are applicable to the auditor, the auditors, and the audit organization. The responsibility for properly planning, performing, and reporting an audit is not limited to an individual auditor, as perceived by Mission management.

Generally accepted government auditing standards for independence are not meant to require that an individual auditor, such as a new inexperienced auditor, be allowed by his/her organization to independently plan and perform an audit, draw conclusions, express opinions and report the results free from any supervisory or organizational oversight and guidance. Rather, generally accepted government auditing standards require supervision and organizational guidance. The standard for independence deals with factors of a personal nature which may bar an individual auditor from participating in an audit; factors which relate to how the audit organization is placed within a government entity, and external impairments. Examples of external impairments include: (1) "interference or influence external to the audit organization that improperly or imprudently limits or modifies the scope of an audit"; and (2) "interference external to the audit organization with the selection or application of audit procedures."

The audit profession is one of evolution, and the fact that the auditing standards change does not invalidate the results of previous audits. Contrary to the perception of Mission management, the Yellow Book was not established in 1988. The Yellow Book--generally accepted government auditing standards--was established in 1972 and was revised in 1974, 1979, 1981, and 1988.[11] Moreover, generally accepted government auditing standards supplement, not supplant, AICPA auditing standards which have evolved significantly since their origin in 1917.[12] In fact, AICPA assisted in the 1988 revisions to the Yellow Book, revisions which were coordinated

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10. Source for applicability to private sector: Codification of Statements on Auditing Standards, AICPA, 1990, AT Section 100.01--"A 'certified public accountant in the practice of public accounting' includes any of the following who perform or assist in the attest engagement...an entity..or by two or more of such persons if they choose to act together."

11. Source: Forward section of the 1981 and 1988 versions of the Yellow Book, Participants Notebook, AGA videoconference, 10/12/88, pg.5.

12. Source: Codification of Statements on Auditing Standards, AICPA, 1990, Appendix A.

with concurrent revisions to AICPA standards.[13] These changes to auditing standards are in response to how the profession evolves in practice and in response to the changing expectations and needs of report users.[14] For the A.I.D. OIG, the shift to attestation-type audit work is new and is in response to the changing needs of A.I.D. management. However, to provide these attestations with reasonable assurance, the OIG has determined that reasonable auditing procedures are not available for ensuring enough valid and reliable (the Yellow Book definition of competent) evidence, if management refuses to explicitly confirm management's implicit assertions about the evidence.[15]

Let us look at just two of the basic implicit assertions which the auditor asked management to explicitly confirm and which management refused to confirm. We will then explain why these confirmations are needed.

Management was asked to confirm <u>to the best of their knowledge and belief;</u> that, for USAID/Egypt's Section 416(b) Food Donation Program, (1) there were no material instances where financial or management information had not been properly and accurately recorded and reported, and (2) there were no instances of noncompliance with A.I.D. policies and procedures or possible violations of laws and regulations.

Verifying the validity of these implicit assertions is absolutely essential in planning and performing the audit and in reporting attestations with reasonable assurance that the Mission had properly and accurately recorded and reported information, had followed applicable internal control policies and procedures, and had complied with applicable legal requirements. But, when management refuses to confirm the validity of these assertions, the auditor does not know whether (1) Mission records and reports are sufficiently valid and reliable, (2) Mission management is aware of known problems which the auditors did not find, or (3) Mission management just does not want to accept responsibility for the assertions. Despite all auditing procedures that are available to the auditor for planning and conducting the audit, management's failure to provide requested written confirmation of management's implicit assertions casts an unresolvable doubt upon the sufficiency of the auditing procedures and of the evidence obtained.

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13. Source: See footnotes 7 and 11.

14. Source: See footnotes 7 and 11.

15. Source for distinction between implicit and explicit assertions: <u>Codification of Statements on Auditing Standards</u>, AICPA, 1990, AU 326.03--Assertions are representations by management that...can be either explicit or implicit.

Simply put, the auditor must disclaim providing an attestation on the validity of any assertion for which management has disclaimed confirmation.[16]

As noted before, in such a situation, the OIG can still report problems which came to the auditor's attention but cannot report that everything else concerning the audited activity is all right. To provide A.I.D. management attestations that the activities are all right, Mission management must be willing to lower our risks by accepting responsibility for the assertions.[17]

MISSION PERCEPTION: *Management's reluctance to issue a representation letter stems from the very nature of performance audits in AID. It is not Management's report that is being audited. The scope of the audit is broad and subject to change. The normative criteria for each objective is unknown to Management and/or subject to change. The activities under audit often have lives of over ten years with different cognizant managers at various periods of time.*

RIG COMMENTS: The Mission does not understand who and what we are auditing.

The OIG is auditing A.I.D. management's assertions, reports, internal controls, and systems. On June 16, 1991, in State 197372, the Inspector General provided the Mission detailed explanations, with questions and answers, on both the new audits of internal controls and the revised audit standards related to representation letters. Our performance audits are now auditing the performance of A.I.D. management. Again, this is in response to concerns expressed by A.I.D. management about the need for more functional audits.

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16. Source: Codification of Statements on Auditing Standards, AICPA, 1990, AU 333.11--"Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion. Further, the auditor should consider the effects of the refusal on his ability to rely on other management representations [implicit assertions]."

17. Source: Codification of Statements on Auditing Standards, AICPA, 1990, AT 100.39--"In an attest engagement designed to provide the highest level of assurance on an assertion (an 'examination' [audit]), the practitioner's objective is to accumulate sufficient evidence to limit attestation risk to a level that is, in the practitioner's professional judgement, appropriately low for the high level of assurance that may be imparted by his or her report. In such an engagement, a practitioner should select from all available procedures--that is, procedures that assess inherent and control risk and restrict detection risk--any combination that can limit attestation risk to such an appropriately low level." AT 100.31--"*Attestation risk* is the risk that the practitioner may unknowingly fail to appropriately modify his or her attest report on an assertion that is materially misstated. It consists of (a) the risk (consisting of inherent risk and control risk) that the assertion contains errors that could be material and (b) the risk that the practitioner will not detect such errors (detection risk)."

For these functional audits, Mission management should be fully knowledgeable of the laws, regulations, policies, procedures, contracts, agreements, and the internal control systems that are related to Mission management's activities. The criteria and the related internal controls are not established by the auditors. The criteria are established in A.I.D. Handbooks, laws, regulations, etc. Although the individual projects and programs of a Mission may change frequently, Mission management systems change less frequently. When those systems are in need of change, as determined through Mission management's portfolio reviews, internal control vulnerability assessments, etc., it is the responsibility of the Mission Director to establish suitable management systems and to define those systems in the form of Mission Orders. Therefore, Mission management should be able to provide representations on activities and systems for which Mission management is the most knowledgeable source.

Given our new audit approach, the nature of a performance audit in A.I.D. should be of less concern to Mission management in deciding whether to provide a management representation letter. Although the scope of the audit can be broad and can be subject to change, the audit objectives and scopes are discussed fully with the Mission and any change is brought to the attention of the Mission. Furthermcre, Mission management is not asked to provide a final management representation letter until a draft audit report--containing the objectives, scope and results of the audit--is provided to Mission management for review and comment. Although the activities under audit can have lives of over ten years with different managers, we are only asking current Mission management to provide a written representation on assertions which to the best of their knowledge and belief are true. For the purpose of attesting to the Mission's internal controls, for example, a violation of law which occurred ten years ago and which current Mission management is unaware of would be of less concern to the auditors than recent violations of law which current Mission management is aware of but has not documented in reports or in the Mission files.

MISSION PERCEPTION: *These major differences vis-a-vis financial audits make it difficult for AID Managers to provide representation letters. During the course of this audit, USAID has provided the auditors with documents pertaining to its Internal Control Systems, made available all its files, and USAID personnel have spent countless hours cooperating with the auditors answering questions and being interviewed. Given the types of evidence presented and available to the auditors throughout the audit, and the various tests to which this evidence can be subjected in determining its sufficiency, relevance and competency, we believe it spurious to qualify an opinion based on a policy, which denigrates Management's good faith efforts as well as the professional judgement of the auditor in planning and conducting his/her audit work.*

RIG COMMENTS: As previously stated, the Mission is confused about the requirements of the audit standards, the purposes of OIG policy, and why, in the auditor's judgement, a representation letter is required to ensure the relevancy and competency of the evidence needed for attestations. RIG/A/Cairo appreciates the efforts of USAID/Egypt management in providing the documents, providing access to Mission files and providing access to Mission personnel. Certainly, the issue here is not one of criticizing those good faith efforts, it is a question of sufficient documentary evidence so the auditor can attest, in accordance with generally accepted government auditing standards, to things that Mission management has done well in managing USAID/Egypt's Section 416(b) Food Donation Program.

Furthermore, we note that the Agency's own interim GC guidance on representation letters issued in June 1991 encourages Mission management to provide management representation letters if management is "confident" in doing so:

> **If A.I.D. managers feel confident in making written audit representations specifically designed to a given audit activity they are encouraged to do so** [State 180913, June 1991].

(The interim guidance also notes that signing a representation letter is a voluntary undertaking and that if managers have any uncertainty, they may consult with their cognizant legal advisor.) Thus, given our intent of meeting a need expressed by A.I.D. management and the Agency guidance encouraging the provision of representation letters so that we can do so, we find it difficult to understand that USAID/Egypt will not confirm management assertions such as:

- The Mission has provided the auditor all essential information related to USAID/Egypt's Section 416(b) Food Donation Program;

- Mission management is responsible for establishing and maintaining the internal controls over USAID/Egypt's Section 416(b) Food Donation Program; and

- Mission management is responsible for compliance with the laws, regulations, binding policies, contracts and agreements applicable to USAID/Egypt's Section 416(b) Food Donation Program.

Such assertions need to be confirmed in almost any audit where we, the OIG, are called to attest that a given Mission function or activity is working well (an "unqualified" or positive opinion). For these and the other assertions, the representation letter in and of itself does not of course provide all of the evidence for such an attestation;[18] it is simply an audit procedure for assuring that (1) the auditor systematically covers the assertions in planning and performing the audit, (2) Mission management gives sufficient thought to confirming the validity of the assertions, and (3) the auditor accurately documents Mission management's response/confirmation.

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18. Source: Evidential Matter: Auditing Interpretations of Au Section 326, Codification of Statements on Auditing Standards, AICPA, 1990, "Written representations from management are a part of the evidential matter the auditor obtains in an audit performed in accordance with generally accepted auditing standards...Obtaining such representations complements but does not replace other auditing procedures that the auditor should perform."

Thus, if Mission management is not confident in confirming these assertions and refuses to confirm the assertions, it should not be surprising that the OIG also would not be confident in providing attestations and would have to report that management's refusal to issue a representation letter constitutes a scope limitation to the audit and precludes the auditors from issuing an unqualified opinion.

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