PD ABE-593

Regional Inspector General for Audit
Cairo, Egypt

Audit of Costs Incurred by United Engineering and Marketing Co. Under USAID/Egypt Contract No. 263-CSO-C-00-0008-00

Report No. 6-263-92-01-N
October 31, 1991

INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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

October 31, 1991

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

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

SUBJECT: Audit of Costs Incurred by United Engineering and Marketing Co. Under USAID/Egypt Contract No. 263-CSO-C-00-0008-00

The attached report dated March 7, 1991 by Price Waterhouse presents the results of a financial audit of United Engineering and Marketing Co.'s (United) expenditures under Contract No. 263-CSO-C-00-0008-00 with USAID/Egypt. United provides maintenance services for Mission offices and leased housing units.

We engaged Price Waterhouse to perform a financial audit of United's direct and indirect costs for the period November 1, 1989 to October 30, 1990. The purpose of the audit was to evaluate the propriety of costs incurred in this period and to recommend actual overhead and fringe benefit indirect cost rates in compliance with United's contract. In performing the audit, Price Waterhouse evaluated United's internal controls and compliance with applicable laws, regulations and contract terms as necessary in forming an opinion regarding the Statement of Contract Costs.

Price Waterhouse was unable to give an opinion on the Statement of Contract Costs due to United's inadequate accounting records. However, the auditors did question LE98,101 out of LE710,432 in audit costs ($37,731 out of $273,243)[1] because the costs may be ineligible for reimbursement, represent accrued costs in a cash basis system or are unsupported by adequate documentation. Additionally, Price Waterhouse noted certain matters involving the internal control structure that are considered to be material weaknesses. For example, United lacked a formal accounting system and did not retain many source documents needed to support costs billed to USAID/Egypt. Price Waterhouse did not note any compliance findings other than United's lack of an accounting system.

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[1] The exchange rate in effect on the date the contract was executed was US$ = 2.60 Egyptian pounds (LE)

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In response to the questioned costs, United claimed that its original proposal noted local business customs precluded receiving receipts for many expenses and that all of the costs incurred were normal costs of doing business in Egypt. Additionally, United stated that it would be willing to work with USAID/Egypt in addressing the internal control findings.

<u>Recommendation No. 1.1:</u> We recommend that USAID/Egypt's Contracting Officer resolve the questioned and unsupported costs.

<u>Recommendation No. 1.2:</u> We recommend that USAID/Egypt require United to establish an adequate financial accounting system.

<u>Recommendation No. 1.3:</u> We recommend that USAID/Egypt and United Engineering reach an understanding regarding the accounting treatment of accrued and unallowable costs and incorporate this agreement in an amendment to United's contract.

These recommendations will be included in the Inspector General's audit recommendation follow-up system. Recommendation No. 1 is resolved upon issuance based on our review of the USAID/Egypt Contracting Officer's determination regarding the questioned and unsupported costs. The recommendation can be closed when any amounts determined to be owed to A.I.D. are paid by United.

We understand that United Engineering has agreed to install an adequate accounting system. This recommendation is therefore resolved and can be closed when we are furnished documentation that United has installed a system that consists of methods and records established to adequately identify, analyze, classify, record and report financial activity, and that this system has been evaluated, after two months of operation, by a USAID/Egypt financial analyst. Should a subsequent financial audit uncover that United is not utilizing this system, Recommendation No. 2 will be reopened by the IG.

Since USAID/Egypt and United Engineering reached agreement regarding the accounting treatment of accrued and unallowable costs at an October 9, 1991 meeting, Recommendation No. 3 is resolved. This recommendation can be closed when we receive a copy of the resulting modification of United's contract.

Please advise this office within 30 days of any actions planned or taken to close the recommendations. We appreciate the courtesies extended to the staff of Price Waterhouse and to our office.

AUDIT OF
UNITED ENGINEERING AND MARKETING CO.
CONTRACT NO 263-CSO-C-00-0008-00
OCTOBER 31, 1990

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AUDIT OF
UNITED ENGINEERING AND MARKETING CO.
CONTRACT NO 263-CSO-C-00-0008-00
OCTOBER 31, 1990

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Price Waterhouse

Mr. Fredrick A. Kalhammer
Regional Inspector General for Audit
Unites States Agency for
International Development
Mission to Egypt
Cairo, Egypt

Dear Mr. Kalhammer:

This report represents the results of our audit of direct Contract No. 263-CSO-C-00-0008-00 between United Engineering And Marketing Co. (United Engineering) and USAID/Egypt for the maintenance of Agency residential buildings.

Background

The purpose of the contract is to provide for the maintenance of safe, comfortable and functional space in which USAID/Egypt employees can live and work.

In 1986 USAID/Egypt took the decision to withdraw from portions of the Joint Administrative Organization (JAO) of the U.S. Embassy in Cairo which hitherto had maintained USAID office and residential space. That year USAID selected United Engineering to replace the JAO in maintaining approximately 80 residential apartments leased by AID for its employees in Cairo. In 1987 United Engineering was selected to maintain the office space in the Cairo Center. In general USAID/Egypt has found the change from JAO-supplied maintenance service to contractor-supplied maintenance service to be

advantageous to the needs of the Agency.

The contract is a cost reimbursement plus fixed fee contract. The total estimated cost of the contract exclusive of fee is LE 830,149. The fixed fee is LE 71,015. The contract period being audited covers from November 1, 1989 to October 31, 1990.

Audit Objectives and Scope

The objective of this engagement was to perform a financial and compliance audit of direct and indirect costs billed to USAID/Egypt by United Engineering Contract No. 263-CSO-C-00-0008-00 for the USAID residences, offices and cafeteria for the period from November 1, 1989 to October 31, 1990. Specific objectives of this audit were:

1. To compute revised overhead and fringe benefit rates for the period November 1, 1989 to October 31, 1990.

2. To determine whether direct and indirect costs incurred conform to the requirements of the contract and the Federal Acquisition Regulations as regards their allowability, allocability, and reasonableness.

3. To determine whether the costs incurred are supported by adequate documentation.

4. To determine whether the accounting system, and relevant internal controls and management practices of United Engineering are adequate.

5. To determine whether United Engineering complies with applicable financial contract terms (including standard contract clauses and provisions) which could have a material financial effect, or the violation of which might result in criminal prosecution.

Preliminary planning and review procedures were performed during December 1990 and consisted of discussions with

RIG/A/C personnel and United Engineering officials. We reviewed the contract and made a review of the accounting system utilized during the period under examination. Audit work commenced in December 1990 at the United Engineering office in Cairo and was completed in March 1991.

Because the company did not maintain adequate accounting records including the retention of source documents to provide sufficient evidence supporting the Statement of Contract Costs and we were not able to apply other auditing procedures to satisfy ourselves regarding the Statement of Contract Costs, the scope of our work was not sufficient to express and we do not express an opinion on the Statement of Contract Costs.

Notwithstanding this limitation, we constructed accounts and reviewed available records to the extent we considered practical. Our selection of disbursements to be reviewed was made on a judgmental basis and was structured to test a majority of expenditures. For certain costs we relied on invoice data and computer records rather than on source documents which are not retained.

We reviewed LE 452,720 of itemized costs billable directly to AID, representing 83.37% of the total of such costs (i.e. excluding fringe pool, overhead pool, and fixed fee). We reviewed LE 478,132 (including LE 452,720 of costs billed directly to USAID) of these same cost classifications for the company as a whole, representing 85.62% of the corresponding total for the company, including non-AID work. We reviewed LE 114,109 of fringe expenses representing 100% of the total of such expenses. We reviewed LE 118,191 of overhead expenses, representing 72.69% of the total of such expenses. In total we therefore reviewed LE 710,432 of expenses representing approximately 82% of all such expenses (incurred and estimated) for the company. As part of this we

identified management estimates of LE 57,694 of future costs attributable to the audited period, equivalent to approximately 6.65% of total company expenses (incurred and estimated).

Our reviews of expenditures included, but were not limited to, the following:

1. Reconciling United Engineering accounting records to invoices issued to USAID and reviewing of costs for allowability.

2. Determining that expenditures were appropriate and conformed with the terms of the contract and relevant regulations.

3. Reviewing that calculated indirect costs and fringe benefits as shown on the invoices were calculated accurately using appropriate base data and percentages.

4. Reviewing of other direct costs for allowability and appropriate support.

As part of our examination we made a study and evaluation of relevant internal controls and reviewed United Engineering's compliance with applicable laws and regulations.

Results of Audit

Statement of contract costs:

Our examination identified LE 98,101 in questioned costs including LE 81,818 in unsupported costs. (LE 57,694 of these are accrued liabilities not yet paid.)

Internal control structure:

Our audit found the internal controls and accounting practices of United Engineering to be inadequate. We recommend that the company adopts an accounting system which achieves USAID requirements.

Compliance with contract terms and applicable laws and regulations:

Our audit found only one significant instance of noncompliance with the terms of the contract, which was the lack of an adequate accounting system. (See description under "Internal control structure").

Management Comments

Management has not accepted the questioned or unsupported costs identified by the audit. Their main objections, in our view, center on the following issues:

1. Unsupported Costs: Management emphasized that it was explicitly stated in the business proposal that many of the expenses under overheads would not have any documents to back them up, and that this had been discussed with the AID Contracts Office, and that it had not been rejected in any of these discussions. Management is also concerned to ensure that estimated future costs attributable to the period being audited will be reimbursed when they are incurred.

2. Questioned Costs: Management insists that all questioned costs are a necessary part of its expenditure for conducting its service to the standards and with the speed required.

This report is intended solely for use by the United States Agency for International Development and may not be suitable for any other purpose.

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Price Waterhouse

March 7, 1991

Regional Inspector General for Audit
United States Agency for
International Development
Mission to Egypt
RIG/A/C Office
Cairo, Egypt

Statement of Contract Costs
Report of Independent Accountants

We were engaged to audit the accompanying Statement of Contract Costs incurred for the period from November 1, 1989 to October 31, 1990 relating to Contract No. 263-CSO-C-00-0008-00 between United Engineering And Marketing Co. (United Engineering) and USAID. This Statement of Contract Costs is the responsibility of United Engineering And Marketing Co. management.

The company's accounting records do not provide sufficient evidence supporting the Statement of Contract Costs to permit the application of adequate auditing procedures. Because we were not able to apply other auditing procedures to satisfy ourselves regarding the Statement of Contract Costs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying Statement of Contract Costs.

Price Waterhouse

Audit Of
United Engineering And Marketing Co.
Contract No 263-C50-C-00-0008-00
Statement of Contract Costs for the Period November 1,1989 through October 31,1990
Part I : Invoiced Costs

All values are in Egyptian pounds.

Category	Provisional Rate (If Applicable)	Total Costs Reimbursed	Proposed Adjustments: Reclass'd Costs	Revised Allocations Using UE-Claimed Costs	Effect of Questioned Costs	Effect of Unsupported Costs	Audit-Proposed Revised Rate	Total Audit-Adjusted Costs	
Management Salaries		123,091						123,091	
Workers Wages		136,121						136,121	
Overtime		52,245						52,245	
Subtotal		311,457						311,457	
Fringe Benefits									
- AID-specific			97,540		0	(25,479)		72,061	See Part II
- Allocated from pool	42.88%	133,553	(97,540)	39,578		(20,214)	17.78%	55,377	See Part V
Intermittent Wages		39,013						39,013	
Other Direct Costs									
- Originally billed		14,463						14,463	
- AID-specific from overhead pool			14,899					14,899	See Part III
Subcontracts		11,184						11,184	
Subtotal of All Direct Costs		509,670	14,899	39,578	0	(45,693)		518,454	
Overhead	22.84%	116,409	(14,899)	32,531	(15,346)	(43,415)	14.52%	75,279	See Part VI
Parts & Supplies		87,188						87,188	
Fixed Fee		71,015						71,015	
GRAND TOTAL		784,281	0	72,109	(15,346)	(89,108)		751,936	
Net Due From/(To) USAID								(32,345)	

See accompanying notes to Statement of Contract Costs.

Audit Of
United Engineering And Marketing Co.
Contract No 263-C50-C-00-0008-00
Statement of Contract Costs for the Period November 1,1989 through October 31,1990
Part II : Fringe Benefits

All values are in Egyptian pounds.

Category	Costs per UE	Questioned Costs	Unsupported Costs	Audit Adjusted Costs	Audit Finding Reference
BENEFITS RECEIVED BY ENTIRE WORKFORCE					
- Accrued Payroll Income Taxes	25,918		(21,873)	4,045	2E
- Management Fringe					
Paid Leave	11,704			11,704	
Sick Leave	7,016			7,016	
Social Insurance	6,784			6,784	
- Technical Fringe					
Paid Leave	9,172			9,172	
Sick Leave	5,150			5,150	
Social Insurance	16,018			16,018	
Subtotal	81,762		(21,873)	59,889	
FRINGE BENEFITS RECEIVED ONLY RELATED TO A.I.D. WORK (NOW RECLASSIFIED AS DIRECT COST)					1
- Management					
Bonus	35,890		(1,668)	34,222	2E
Termination	12,911		(12,845)	66	2E
- Technical					
Bonus	34,163		(2,725)	31,438	2E
Termination	14,576		(8,241)	6,335	2E
Subtotal	97,540		(25,479)	72,061	
GRAND TOTAL	179,302		(47,352)	131,950	

See accompanying notes to Statement of Contract Costs.

Audit Of
United Engineering And Marketing Co.
Contract No 263-C50-C-00-0008-00
Statement of Contract Costs for the Period November 1,1989 through October 31,1990
Part III : Overhead Costs

All values are in Egyptian pounds.

Category	Costs per UE	Questioned Costs	Unsupported Costs	Audit Adjusted Costs	Audit Finding Reference
OVERHEAD ATTRIBUTABLE TO COMPANY AS A WHOLE					
Rent	22,100.00		(19,200.00)	2,900.00	2A
Office Supp.	3,243.17			3,243.17	
Donations	4,924.25		(4,924.25)	0.00	2B
Bank Charges	152.80			152.80	
Post, Telephone, & Telex	4,345.34			4,345.34	
Transportation	1,849.80			1,849.80	
Stationery	4,106.50			4,106.50	
Electricity	2,171.70			2,171.70	
Maintenance	3,192.85			3,192.85	
Cleaning	1,915.04			1,915.04	
Car Expenses	4,326.12			4,326.12	
Computer Supplies	1,710.25			1,710.25	
Uniforms	0.00			0.00	
Entertainment	1,908.88	(1,908.88)		0.00	2C
Gifts	13,282.50	(13,282.50)		0.00	2C
Medical Expenses	0.00			0.00	
Traveling Expenses	0.00			0.00	
Miscellaneous	3,387.60	(1,091.50)		2,296.10	2D
Depreciation	25,188.23			25,188.23	
Consumable Tools	7,636.41			7,636.41	
Tax Reserve	15,000.00		(4,673.00)	10,327.00	2E
Renovation Reserve	5,000.00		(2,669.00)	2,331.00	2E
Audit Fee	5,000.00		(3,000.00)	2,000.00	2E
Subtotal	130,441.44	(16,282.88)	(34,466.25)	79,692.31	
OVERHEAD ATTRIBUTABLE EXCLUSIVELY TO A.I.D. WORK (NOW RECLASSIFIED AS DIRECT COST)					
Drop Cloth Washing	995.00			995.00	
Consumables (Drop Cloths)	1,303.50			1,303.50	
Car Compensation	12,600.00			12,600.00	
Subtotal	14,898.50			14,898.50	
GRAND TOTAL	145,339.94			94,590.81	

See accompanying notes to Statement of Contract Costs.

Audit Of
United Engineering And Marketing Co.
Contract No 263-C50-C-00-0008-00
Statement of Contract Costs for the Period November 1,1989 through October 31,1990
Part IV : Estimated Future Costs Attributable to Audited Period

All values are in Egyptian pounds.

Category	Estimated Direct Costs	Estimated Fringe Costs	Estimated Overhead Costs	Total Estimated Costs
Bonus	4,393			4,393
Termination	21,086			21,086
Accrued Payroll Income Taxes		21,873		21,873
Tax Reserve			4,673	4,673
Renovation			2,669	2,669
Audit Fee			3,000	3,000
Total	25,479	21,873	10,342	57,694

See accompanying notes to Statement of Contract Costs.

See also Audit Findings 2E and 3.

Audit Of
United Engineering And Marketing Co.
Contract No 263-C50-C-00·0008-00
Statement of Contract Costs for the Period November 1,1989 through October 31,1990
Part V : Calculation of proposed revised fringe benefits rate

All values are in Egyptian pounds.

1. Labor Cost Allocation Base = Total Company Direct Salary Costs

. Management	145,779	
. Workers	162,503	
. Overtime	28,587	
	----------	336,869
		==========

2. Revised Fringe Rate = Total Audit-Adjusted Fringe Pool / Total Company Direct Salary Costs
(See Part II) (See above)

= 59,889 / 336,869

= 17.78%
==========

See accompanying notes to Statement of Contract Costs.

See also Audit Finding 4.

Audit Of
United Engineering And Marketing Co.
Contract No 263-C50-C-00-0008-00
Statement of Contract Costs for the Period November 1,1989 through October 31,1990
Part VI : Calculation of proposed revised overhead rate

All values are in Egyptian pounds.

1. Direct Cost Allocation Base = Total Direct Costs (Per Part I Definition)

- Total Company Direct Costs

. Total expenditure		834,399	
. Fixed asset purchases		(44,637)	
. Total expenses		789,762	
. Less			
..Overhead Pool ACTUAL Expenditure (with questioned costs; see Part III)			
Total overhead	130,441		
Depreciation	(25,188)		
Accrued tax	(4,673)		
Accrued renovation	(2,669)		
Accrued audit fee	(3,000)		
		(94,911)	
..Parts and Supplies			
AID direct-purchase		(75,924)	
UE direct-purchase		(57,177)	
Stores purchases		(12,800)	
		(145,901)	
. Total Company Direct Costs			548,950

2. Revised Overhead Rate = Total Audit-Adjusted Overhead Pool / Total Company Direct Costs
(See Part III) (See above)

= 79,692 / 548,950

= 14.52%

See accompanying notes to Statement of Contract Costs

See also Audit Finding 5.

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AUDIT OF
UNITED ENGINEERING AND MARKETING CO.
CONTRACT NO 263-CSO-C-00-0008-00
NOTES TO STATEMENT OF CONTRACT COSTS

NOTE 1 - SOURCE OF DATA

The column labeled "Total Cost Reimbursed" on Part I, and the columns labeled "Costs per UE' on Parts II and III are the responsibility of United Engineering and Marketing Co. (United Engineering). The figures shown on Part IV are the estimates of United Engineering and Marketing Co. for liabilities which they have under the terms of this contract, but which were not paid within 90 days of the end of the period being audited.

The other columns have been developed for the purpose of this report based on our audit of those figures.

NOTE 2 - ORGANIZATION AND BASIS OF PRESENTATION.

The Statement of Contract Costs has been prepared on the basis of cash disbursements except for management salaries, which are billed in accordance with contractual provisions. Consequently, costs invoiced are not necessarily recognized when the liability is incurred. Additionally, the Statement has been prepared to the extent possible, given the disclaimer of an opinion, in accordance with the cost principles set forth in The Federal Acquisition Regulations, which prescribe the nature and treatment of reimbursable costs not specifically defined in the contract.

NOTE 3 - DESCRIPTION OF CONTRACT

The contract is a cost reimbursable plus fixed fee direct contract between United Engineering and the United States Agency for International Development.

NOTE 4 - QUESTIONED AND UNSUPPORTED COSTS

Questioned and unsupported costs consist of audit findings proposed on the basis of the terms of the contract and the accounting principles described in Note 2, and are detailed in the "Statement of Contract Costs - Audit Findings" section of this report.

AUDIT OF
UNITED ENGINEERING AND MARKETING CO.
CONTRACT NO. 263-CSO-C-00-008-00
STATEMENT OF CONTRACT COSTS
AUDIT FINDINGS

1. Costs Billed Directly

Discussion

The following costs shown as indirect costs in the business plan proposal are exclusively attributable to AID:

- Bonus payments
- Termination payments
- Drop cloth purchases and washing
- Car compensation.

Recommendation

We recommend that any expenditure which is 100% attributable to AID should be directly charged and not included in the fringe or overhead pools.

2. Questioned and Unsupported Costs

Discussion

The following fringe benefit and overhead costs are not

supported or are questioned:

Description	Questioned Costs L.E.	Unsupported Costs L.E.	Notes
- Rent		19,200	A
- Donations expenses		4,924	B
- Entertainment expenses	1,909		C
- Gifts	13,282		C
- Fine	1,092		D
- Accrued and estimated expenses		57,694	E
Subtotal L.E.	16,283	81,818	
Grand total L.E.	98,101		

The net impact of these amounts, together with the proposed revised rates(see Recommendations 4 & 5) is as follows:

	LE
- Revised allocations using UE-claimed costs	72,109
- Effect of questioned costs	(15,346)
- Effect of unsupported costs	(89,108)
Net due from/(to) USAID	(32,345)

See also Part I of the Statement of Contract Costs.

Recommendation

We recommend that USAID/Egypt resolve the questioned and unsupported costs identified above, netting to LE 32,345 (LE 89,108 unsupported).

Notes:

A. Rent

Findings

There is no lease contract for the offices occupied by the President and the administrative staff, and there are no receipts for actual payments. Hence there is no evidence that the amounts stated have actually been paid.

B. Donation expenses

Findings

A number of donations to individuals have been made which are not supported by receipts.

C. Entertainment and Gifts

Findings

The amounts were incurred for business dinners and for purchasing gifts to facilitate the company's existing operations. FAR 31.205-8 (Contributions or Donations) and FAR 31.205-14 (Entertainment Costs) specify that these costs are not allowable.

D. Fine

Findings

The amount represents a penalty imposed by the authorities in accordance with the Egyptian labor law for recruiting some of the company's staff directly without prior notification to the

work bureau about vacant positions available in the company. FAR 31.205-15 (Fines, Penalties, and Mischarging Costs) specifies that this cost is not allowable.

E. Accrued and estimated expenses

Findings

The contract requires that liabilities incurred be paid within 30 days (90 days for some employee benefits) of their billing.

The following amounts claimed by United Engineering as expenses attributable to the period under audit had not been paid within 90 days after the end of the audit period:

Description		Amount
Bonus payments	LE	4,393
Termination provision		21,086
Accrued payroll income taxes		21,873
Tax reserve		4,673
Renovation		2,669
Audit fee		3,000
Total	LE	57,694

We recognize that these may yet have to be paid, but that any reimbursement would have to be in the future, at the time they are incurred, or else as separately negotiated between United Engineering and USAID.

3. Estimated Future Costs

Discussion

There are a number of future costs estimated by United Engineering as attributable to the audited period. Some of these are direct costs, some are fringe, and some are overhead. They are detailed on Part IV of the Statement of Contract Costs. (See also Audit Finding 2E.)

The contract and Federal Acquisition Regulations generally prohibit reimbursement in advance of contractor disbursement except within limited time-frames. United Engineering management is understandably concerned to ensure that it does not incur a loss when the costs are eventually paid, due to the Statement of Contract Costs for the relevant period already having been finalized.

There are also effects on indirect cost rates from these payment delays. In particular:

a) Delays in paying direct costs (bonuses and termination payments) will result in AID paying a smaller share of current fringe and overhead costs.

b) Delays in paying fringe and overhead costs (e.g. payroll taxes) could result in a need for different rates for different years, depending on when actual expenditure is expected.

Recommendation

USAID and United Engineering should confirm the treatment of estimated future costs. We suggest the following clarifications:

- That the existence of future liabilities be explicitly recognized by USAID for United Engineering;

- That such costs are billed only when incurred, so long as a cost-incurred contract continues to operate; and

- That all outstanding estimated future costs be negotiated for a one-time lump-sum payment in the event of contract termination.

4. **Fringe Benefits Rate**

Discussion

The provisional fringe benefits rate per the contract was 42.88%.

As a result of our audit of actual costs (see Parts I and II of the Statement of Contract Costs), we consider that this rate should be revised to 17.78% for the period being audited. (See Part V of the Statement of Contract Costs).

This revised figure is based on calculations which exclude accrued payroll taxes.

Recommendation

The fringe benefits rate should be revised from 42.88% to 17.78% for the period being audited.

USAID and United Engineering may wish to negotiate a higher provisional rate for the next period to reflect any anticipated actual payments of payroll taxes.

5. Overhead Rate

Discussion

The provisional overhead rate per the contract was 22.84%. As a result of our audit of actual costs (see Part I, II, and III of the Statement of Contract Costs), we consider that this rate should be revised to 14.23% for the period being audited. (See part VI of the Statement of Contract Costs).

This revised figure is based on calculations which exclude some accruals or estimates attributable to the period being audited.

Recommendation

The overhead rate should be revised from 22.84% to 14.23% for the period being audited.

USAID and United Engineering may wish to negotiate a higher provisional rate for the next period to reflect any anticipated change in levels of actual payments made.

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Price Waterhouse

March 7, 1991

Regional Inspector General
United States Agency for
International Development
Mission to Egypt
RIG/A/C Office
Cairo, Egypt

Report on Internal Control Structure
Report of Independent Accountants

We were engaged to audit the Statement of Contract Costs relating to the contract between United Engineering And Marketing Co. (United Engineering) and the United States Agency for International Development for the period from November 1, 1989 to October 31, 1990 and have issued our report thereon dated March 7, 1991. In which we disclaimed an opinion due to limitations to the scope of our work.

In planning and performing our audit of the Statement of Contract Costs Of United Engineering for the period from November 1, 1989 to October 31, 1990 we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the Statement of Contract Costs and not to provide assurance on the internal control structure.

The management of United Engineering is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguard against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projections of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we determined the significant internal control structure policies and procedures to be in the categories of disbursements and vouchering. For these internal control structure categories cited, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be material weaknesses under standards established by the

American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The material weakness noted is the lack of a formal accounting system and non-retention of many source documents and is discussed in more detail in the "Internal Control Structure - Audit Findings" section of this report.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might considered to be material weaknesses as defined above.

This report is intended for the information of United Engineering's management and for the United States Agency for International Development. The restriction is not intended to limit the distribution of this report which is a matter of public record.

Price Waterhouse

UNITED ENGINEERING AND MARKETING CO.
CONTRACT NO. 263-C80-C-00-0008
INTERNAL CONTROL STRUCTURE
AUDIT FINDINGS

An accounting system should be implemented which achieves segregation of duties; segregation of bank accounts; retention of source documents; improved voucher design; maintenance of adequate record books; and preparation of regular financial management information.

Discussion

United Engineering has grown rapidly over the past several years, principally as a result of its work for USAID. However a formal accounting system has never been set up. As a result we noted the following:

- One individual handles most accounting functions, including control of cash, recording, and reporting.

- There is not a separate bank account for the company. Rather the President's personal account is used which impedes recognition of company cash assets and cash flows.

- Source documents are thrown away after they have been used for the job billing and payroll systems, (e.g. work orders, time sheets and attendance records).

- The vouchers used to record payments do not indicate classification or approvals.

- There is no general ledger to record all costs and revenues.

- Hard copies are not maintained of invoices sent to USAID and other customers.

- There is no management information about the profitability or otherwise of the company, or of its overall financial position.

As a result it is impossible to audit much of the activity of the company. It also requires a labor intensive manual exercise to classify and analyze costs between direct, fringe and overhead. It is also difficult to determine a quantitative basis for the allocation of fringe and overhead costs between USAID and other customers.

Management is likewise limited in its own ability to monitor performance and profitability. Management review is primarily limited to cash position monitoring and subjective assessments of overall performance.

It should be noted that United Engineering is required by Federal Acquisition Regulation clause 52.315-2, included in its contract by reference, to maintain "books, records, documents, and other evidence and accounting procedures and practices, sufficient to reflect properly all costs claimed to have been incurred or anticipated in performing this contract."

Recommendation

The company should adopt an accounting system in which the following objectives or goals could be achieved.

- Segregation of duties.
- Segregation of company funds from the President's personal funds.
- Retention of source documents
  * Work orders
  * Time sheets
  * Attendance records which can identify sick leave, vacations, etc.

- Recording expenses on preprinted vouchers which show classification and authorization.
- Maintenance of adequate records.
  * General ledger which allows analysis of direct and indirect costs.
  * Subsidiary ledgers (the job costing system by client or customer).
- Retaining copies of invoices.
- Preparation of monthly management reports on financial results.
- Preparation of annual audited financial statements (including income, financial position, and cash flows).
- Classifying costs clearly between direct, fringe benefits and overheads. Clarification should be sought from USAID for any questionable classifications.

Auditee's Response

As a matter of fact the company has a bank account, but the transaction made through the bank are extremely limited since over 90% of our expenses are spent in cash. The purpose of using the president's funds are replacing credit bank facilities and are used to cover for the negative flow, a situation that is happening most of the year, since you may have noticed all our invoices are settled at least 4 to 5 weeks after we started spending, i.e. we have outstanding payment with USAID at any one time of at least two invoices of about L.E. 70,000 to 80,000 add to it the original investments in assets that do not fall under direct costs, being computers, electrical appliances, furniture , etc...

Referring to work orders and time sheets, we do not need them once they are computerized, the invoices have been checked and approved for payment by the project officer; and we were never informed that theirs documents were needed for auditing purposes.

Referring to all recommendations, if they are accepted and or modified by USAID, I am fully prepared to discuss them and work out the necessary costing in management consultancy, increase in administrative manpower and computer facilities and office space to apply them all.

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Price Waterhouse

March 7, 1991

Regional Inspector General
United States Agency for
International Development
Mission to Egypt
RIG/A/C/ Office
Cairo, Egypt

Report on Compliance with Agreement Terms
And Applicable Laws And Regulations
Report of Independent Accountants

We were engaged to audit the Statement of Contract Costs relating to the contract between United Engineering and Marketing Co. (United Engineering) and the United States Agency for International Development, for the period from November 1, 1989 through October 31, 1990 and have issued our report thereon dated March 7, 1991 in which we disclaimed an opinion due to limitations to the scope of our work.

Compliance with laws, regulations and contract clauses applicable to the contract is the responsibility of United Engineering management. As part of obtaining reasonable assurance about whether the Statement of Contract Costs is free of material misstatement, we performed tests of United Engineering's compliance with certain provisions of laws, regulations and contracts. However, our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests indicate that, with respect to the items tested, United Engineering complied, in all material respects, with the provisions referred to in the preceding paragraph with the exception of the failure to have an adequate accounting system, which is reported separately in our "Report on Internal Control Structure". With respect to items not tested, nothing came to our attention that caused us to believe that United Engineering had not complied, in all material respects, with those provisions.

This report is intended for the information of United Engineering's management and for the United States Agency for International Development. The restriction is not intended to limit the distribution of this report which is a matter of public record.

Price Waterhouse

AUDIT OF
UNITED ENGINEERING AND MARKETING COMPANY
RURAL SMALL SCALE ENTERPRISE CREDIT PROJECT
COOPERATIVE AGREEMENT NUMBER
263-0161-A-00-7254-00

Appendix A: Auditees' response to findings

1. **Costs Billed Directly**

Referring to my original proposal based on which the contract costings were worked out, the contracting officer had accepted the basis of calculation for bonus payments and termination payments to be included in the fringe benefit factor, and the drop cloth purchases and washing and car compensation to be included in the overhead factor.

I have not been advised neither verbally nor in writing about anything different than what is stated above.

If AID is prepared to accept your recommendations for the future, I would be prepared to discuss it with them.

2. **Questioned and Unsupported Costs**

A. **Rent**

I would refer here to my original proposal presented to AID, based on which the contract details were worked out, I stated explicitly that many of the expenses under fixed overheads will not have any document to back them up and asked that it was imperative for this local business trend to be accepted. This point was discussed with the contracting office as a base without which it was impossible for me to accept the principle of the contract expenses evaluation, and have asked for

this clause to be added to the contract but was told that this was impossible and that the proposal as is will be put in our file and the auditors who are familiar with local business trends will evaluate if this expenses are reasonable. I was never told neither verbally nor in writing that this reserve i.e my proposal was refused by USAID.

Physically all through the year, we have been present in this office daily. Logically, this office space must have a rent; hence forth because of absence of a lease contract we have been paying rent that is less than half the market value for a similar floor space and similar area location. This has enabled me to directly save for myself and indirectly for my customers (AID being one of them) LE 50,000 being a difference in rent payment and for the purpose of tax paying, which any way is a concept that is not accepted by our Landlord.

B. Donation expenses

(Please read in conjunction with first paragraph under RENT)

I would rather call these expenses part of business operating expenses.

The basis of operation of our company is to concentrate and give all our time and effort to technical excellence. We have to eliminate a lot of business problems non related to technical know how. You have to bear in mind that we have many cars with our staff, circulating everyday morning and night in high security areas, we use regular cars not American Embassy cars, we have sometimes in our cars transmitters/receivers given to us by USAID, our crew stop at USAID residences and sometimes carry USAID property from one location to another.

If we are not relying on the understanding of the concerned people we can simply spend our time clearing UEMCO cars and working staff from interrogations by security responsible.

It has to be clear and taken into consideration that USAID is a very special and sensitive customer, since vis a vis local authorities these are American diplomats.

Also for security reasons we have through our contacts to clear all staff working for the company through security channels before presenting them to AID for final clearance.

Again a part of these donations are in fact, an operating expense, being money non chargeable to work orders for building's maintenance technicians to allow us cut-off building's water supply for repair work, the porters to allow us use elevators etc....

Please be aware that due to these contacts we are one of the rare companies, taking into consideration the size of company, that do not have a lawyer on the payroll or have used during this year any legal consultancy firms, the cost of which also would not have been documented and definitely would have reached this amount of expense and would have taken years to solve any problem.

C. Entertainment and Gifts

(Please read in conjunction with first paragraph under Donation Expenses)

This representational expense in fact is non more than 15 to 20% from the real amounts spent to entertain people that can only make business smooth going. The majority of entertaining is done at my residence and is

therefore not charged to the company.

As for the gifts you will notice that these are hundreds of very small cheap items. I would like to clarify that in the course of business we deal with an enormous number of technicians and engineers working for the electrical and water supply authorities located in all geographical locations of Cairo City to solve the problems that fall outside the residences and that directly affect the resident either an electricity cut out or electrical phase out, or repair work on water pumps that needs a cut in the main water supply. If we do not have access to these people we can not solve these problems immediately.

Same rule applies to the Social Insurance clerks; any problem arising with them may cause misevalution of the Social Insurance value and a lot of problems may arise, or a delay in data entry of our settlement cheques on the Social Insurance computer may cause interests payment in spite the fact that we pay our cheques far in advance of the deadline. Same rule applies to the medical insurance, our staff may not be taken care of medically when transferred for treatment.

For your information all these low ranking bureaucrats can cause a lot of problems and waste a lot of money and time. Again, we are doing business in Egypt, a very low income country for all public employees and these small gifts presented on the occasion of the New Year is done by all companies in Egypt, public and private, dealing with this type of employees.

It is not considered a donation, it is considered a gracious gesture on our part for all immediate services received all through the year.

D. Fine

The purpose of notifying the work bureau about vacant positions is for them to send us candidates for the jobs.

I think AID is very well aware of the quality, background and technical capability of all staff working on this project. We have to maintain the standard of all working staff.

Our system of recruitment is, temporarily getting technicians and engineers, testing them and training them and cross training them, if they succeed all through the testing period and reach our standards they are permanently added to the work force.

We can not possibly wait for correspondence between the company and the work bureau, knowing in advance the quality of people they send, since we, at no time, can be understaffed to be able to respond to AID's random requirements according to the terms of the contract. We have to perform according to our presetted standards and accept these penalties as part of our business cost for a unique professional technical performance.

E. Accrued and estimated expenses

Referring to my original proposal based on which the contract costings were worked out, the contracting officer had accepted the basis of calculation for bonus payments and termination payments to be included in the fringe benefit factor and therefore were paid to UEMCO partially in each invoice, specially that the termination may not happen during the lifetime of this contract and therefore we cannot possibly come back to USAID many years after the termination of this contract to ask for such payments.

Your suggestion that AID pays these expenses when they incur affects the factors for fringe benefit and overhead for the specific year under audit and if these are paid during the next year they will fall under different values for overhead and fringe factors.

3. **Estimated Future Costs**

All these estimated future costs directly affects the fringe benefit factor and the overhead factor of the year under audit since they are costs included in the calculations of these factors.

I am unable to comment unless I know how these budgets are going to be transferred to the year following the year under audit thus affecting its fringe benefit and overhead factors.

4. **Fringe Benefits Rate**

Since the total concept of my proposal to Messrs. USAID based on which the fringe benefit factor has been calculated has been changed, I am unable to give a response specially that some of the expenses will be transferred to the year next to the year under audit, and I have no means in evaluating the impact of these transfers on the next years fringe benefit factor.

5. **Overhead Rate**

Again since the concept of my proposal to Messrs. USAID based on which the overhead factor has been calculated has been changed, I am unable to give a response, specially that you have excluded many of the expenses of the company for different reasons in spite the fact that all of them were clarified and discussed in details with the contracting officer before the signature of the contract, and none of them was explicitly rejected or disapproved neither verbally nor in writing.

AUDIT OF
UNITED ENGINEERING AND MARKETING CO.
CONTRACT NO. 263-CSO-C-00-008
ADDITIONAL MANAGEMENT COMMENTS

Appendix B: Additional Management Comments

Auditee's Comments

It was my understanding and belief that the purpose of auditing this contract was to check that the overhead and fringe benefit factors are realistic or needed adjustments according to the proposal presented to Messrs. AID with all its details based on which I have reached the factors which have been used all through the year under audit.

The final presentation you have reached is totally new to me and hardly understandable and has completely ignored my comments and reserves in my proposal which were all discussed in details with the contracting officer before the signature of the contract, and none of my reserves or basis of calculation was rejected neither verbally nor in writing, and all your questions and findings were explicitly stated and discussed before hand without any objections.

The time consumed to discuss with yourselves the audit details has been enormous, and in all honesty UEMCO does not have the manpower with the necessary background to deal with these financial and administrative reporting requirements, and eventually follow up and tying between accrued budgets and actual budgets and the reworking of the invoicing procedures to identify direct cost and indirect costs. As Price Waterhouse, with all your expertise, you had to inquire from your office in tne States to clarify certain things, what about UEMCO with its limited experience in the contractual administration of such a contract.

You are now very well aware of the size of the company and its staffing on the administrative side.

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

RECEIVED
29 OCT 1991

MEMORANDUM

OCT 29 1991

TO: Philippe Darcy, RIG/A/C

FROM: George Wachterheim, D/DIR

SUBJECT: Draft Audit Report of Audit of Incurred Costs of United Engineering and Marketing Co. Under USAID/Egypt's Contract No. 263-CSO-C-00-0008-00

Draft Audit Report dated 24 September 1991

Recommendation No. 1.1

We recommend that USAID/Egypt's Contracting Officer resolve the questioned and unsupported costs.

Mission Response

The Contracting Officer has made the following determinations with regard to the questioned and unsupported costs listed on page 16 of the draft audit report:

Questioned Costs

Entertainment expenses - LE1,909 The Contracting Officer has determined that, in accordance with FAR 31.205-14, entertainment expenses are not an allowable cost. This amount is therefore sustained.

Gifts - LE13,282 The Contracting Officer has determined that, in accordance with FAR 31.205-1, expenses for gifts are not allowable costs. This amount is therefore sustained.

Fine - LE1,092 The Contracting Officer has determined that, in accordance with FAR 31.205-15(a), expenses for payment of fines is not an allowable cost. This amount is therefore sustained.

With regard to these questioned costs, the Contracting Officer has informed the auditee that such costs were never anticipated as part of the cost of this contract, nor were they condoned at any time in the past, nor will they be condoned in the future. If, as a cost of doing business, the auditee feels that these types of expenditures are necessary, they must come out of profit or other sources of funds than those paid by USAID for either direct or indirect costs.

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Unsupported Costs

Rent - LE19,200 The Contracting Officer has determined that this is an allowable cost, despite the lack of supporting documentation. United Engineering has requested a rental contract and receipt from the landlord without success. United Engineering has occupied this office space for many years prior to this contract, the amount of rent for this space is at a fair market rate, and the cost of a move to alternate space in order to obtain a receipt would not be in the interests of United Engineering nor USAID.

Donations expenses - LE4,924 The Contracting Officer has determined that this is an allowable cost, despite the lack of supporting documentation. The term used in the audit report, "Donations", is, in the considered opinion of the Contracting Officer, incorrect. These expenses are small, "fees-for-service" type payments made in the course of performing United Engineering's work under this contract. The nature of these payments is made clear in the auditee's comments on the draft audit report. The lack of supporting documentation is understandable, and acceptable, given the context in which the payments are made, i.e., payment to a doorman to permit use of an elevator for freight, payment to a washer-woman on the Nile for cleaning of drop cloths, etc. Many of the recipients of these payments are illiterate, and expecting them to provide a receipt is illogical. United Engineering does maintain internal records of these payments. The Contracting Officer has requested that United Engineering continue to record such expenditures in a log book, and obtain third party signatures and/or receipts whenever possible.

The auditee maintains that it was made clear in its proposal that many of the overhead expenses would not have documentation to support them, and that this was known and understood by the Contracting Officer. This is true of the "fee-for-service" type of miscellaneous expenses which have been categorized in the audit as "donations", and which have been discussed above. However, the Contracting Officer made it clear to the auditee during negotiations that while small, miscellaneous payments to doormen, washer-women, car park attendents, etc., would be acceptable without a third party receipt, that large expenditures and those to professionals, i.e., accountants, lawyers, etc. would require receipts. The rent expense is being allowed without supporting documentation only due to the fact that to disallow such expense, which is at fair market value, and from which USAID has received known benefit, would not be fair nor reasonable. The auditee has been cautioned to do its utmost to obtain receipts from all parties to whom it makes payments, large or small. When this is simply not possible, the auditee must document the payment in detail in its own records, in order to allow USAID to determine the allowability, allocability, and reasonableness of the expense.

Accrued and Estimated expenses - LE57694 The Contracting Officer has determined that, with the exception noted below, these expenses are allowable for inclusion in United Engineering's indirect cost pool. The problem with this type of expense was not one of allowability, rather one of accounting method. United Engineering's cost basis system of accounting was not adequate to properly record and treat accruals and contingent liabilities. In response to Recommendation No. 1.2, discussed below, United Engineering will obtain an accounting software package in order to enable them to accurately treat such expenses in the future.

Renovation expense - LE2,699 This should not be treated as an accrual, rather this estimated expense should be recorded in the year it is actually incurred, and amortized over the estimated life of the renovation.

Therefore, of the LE57,694 which was questioned in the audit report, the Contracting Officer has determined that LE54,995 is allowable, and LE2,699 is sustained.

Based on the above discussion and Contracting Officer determinations, we hereby request that this Recommendation be issued as "Resolved". As a result of the above determinations, USAID will recalculate United Engineering's indirect cost pools and determine the correct indirect cost rates for the audited period. Once this is done, a determination can be made as to whether money is due either party. Upon collection of any monies due USAID, or a determination that none are due, the Mission will formally request closure of Recommendation No. 1.1.

Recommendation No. 1.2

We recommend that USAID/Egypt require United Engineering to establish an adequate financial accounting system.

Mission Response

The Office of Financial Management has identified several commercially available software packages which are suitable for United Engineering's accounting needs. United Engineering has agreed to purchase such a package and make available its premises and personnel for training in its use, by USAID personnel from the Office of Financial Management.

Based on the above discussion, we hereby request that this Recommendation be issued as "Resolved". After installation of the accounting system, and its use for a trial period of two months, the Office of Financial Management will report on the adequacy of the system in operation. At that time, the Mission will request closure of this Recommendation No. 1.2.

Recommendation No. 1.3

We recommend that USAID/Egypt and United Engineering reach an understanding regarding the accounting treatment of accrued and unallowable costs and incorporate this agreement in an amendment to United's contract.

Mission Response

At a meeting held between United Engineering and USAID representatives, on October 9, 1991, such an agreement was reached. Unallowable costs as identified above under the Mission response to Recommendation No. 1.1 are not to be included as direct charges to the contract, nor in the indirect cost pool. Accrued expenses and contingent liabilities will be treated in accordance with accepted accounting practices and in accordance with the accounting package which will be selected in consultation with the Office of Financial Management. These agreements, to the extent practicable, will be codified in the next Modification to the United Engineering contract, due to be issued o/a November 1, 1991.

Based on the above discussion, the Mission requests that this Recommendation No. 1.3 be issued as "Resolved". Upon issuance of the Modification, this will be provided, and closure of the recommendation will be requested.

APPENDIX D

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