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Regional Inspector General for Audit
Cairo, Egypt

Audit of Environmental Quality International's Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs Under USAID/Egypt Contract No. 263-0000-C-00-2203-00 and the Audit of Indirect Costs and Fringe Benefits Rate For the Years Ended December 31, 1991 and 1992.

Report No. 6-263-94-016-N
June 27, 1994

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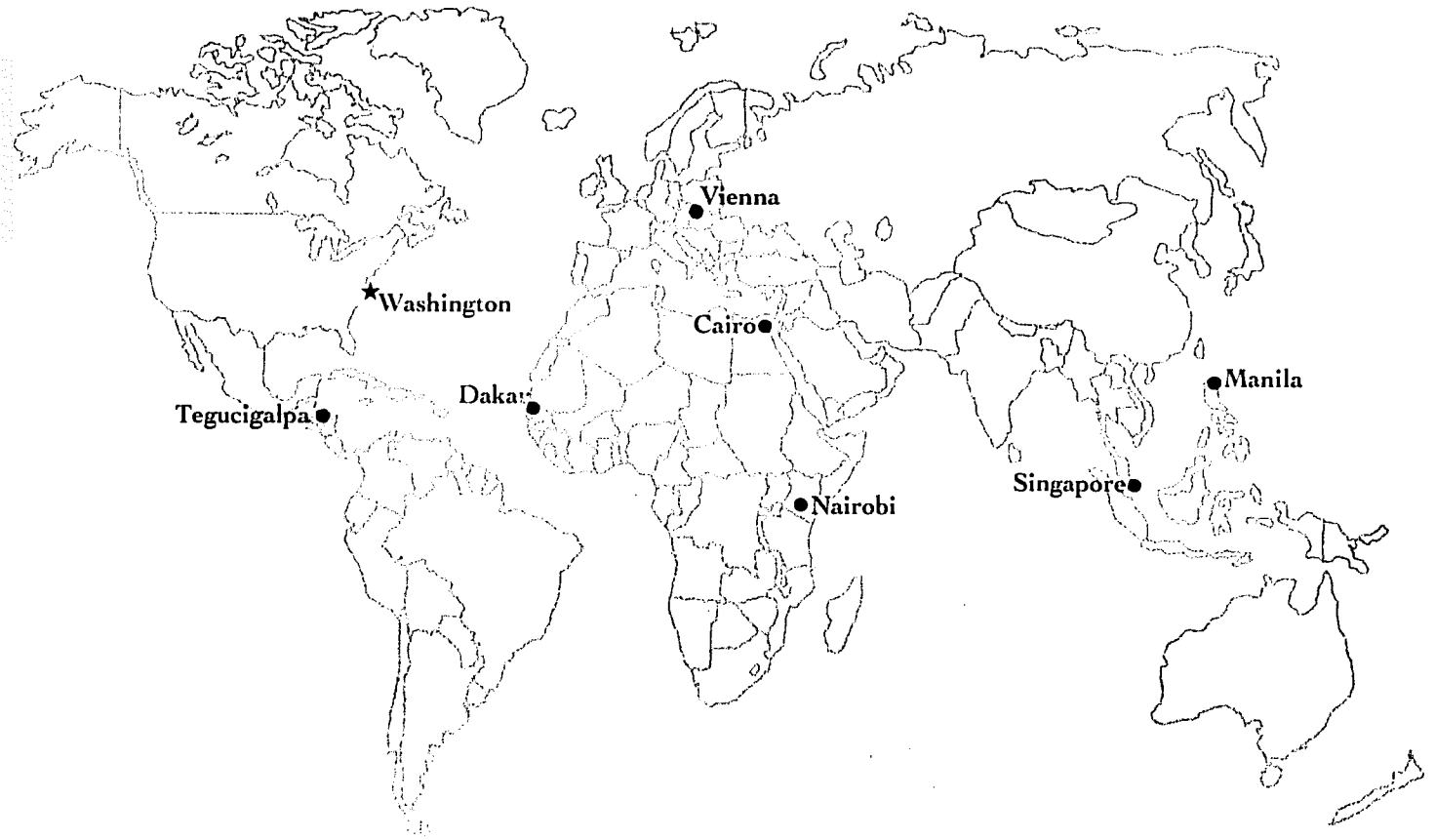

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UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL/AUDIT

June 27, 1994

MEMORANDUM FOR A/D/USAID/Egypt, Christopher Crowely

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

SUBJECT: Environmental Quality International Audit of Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs Under USAID/Egypt Contract No. 263-0000-C-00-2203-00 and the Audit of Indirect Cost and Fringe Benefits Rate For the Years Ended December 31, 1991 and 1992.

The attached reports dated December 20, 1993, by Allied Accountants present the results of a financial audit of Environmental Quality International's Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs Under USAID/Egypt Contract No. 263-0000-C-00-2203-00 and the Audit of Indirect Cost and Fringe Benefits Rate For the Years Ended December 31, 1991 and 1992. Environmental Quality International's (EQI) directive is to ascertain that nonexpendable property provided by USAID for Egyptian agencies is being utilized for project purposes. Under the contract EQI, shall examine the adequacy of GOE internal control systems and monitor the use of nonexpendable property provided by USAID for Egyptian agencies responsible for implementing USAID funded projects.

We engaged Allied Accountants to perform a financial audit of Environmental Quality International's incurred expenditures of LE759,270 (equivalent to $228,009) for the period May 17, 1992 through May 17, 1993 and indirect cost and fringe benefits for the year ended December 31, 1992 amounting to LE2,959,828 (equivalent to $891,514) and LE2,804,581 (equivalent to $860,301) for the year ended December 31, 1991. The purpose of the audit was to evaluate the propriety of costs incurred during those periods. Allied Accountants evaluated EQI's internal controls and compliance with applicable laws, regulations and grant terms as necessary in forming an opinion regarding the Fund Accountability Statement and schedules of indirect costs and fringe benefits.

Allied Accountants questioned $3,688 in incurred costs for the year ended May 17, 1993 billed to USAID by EQI (including $460 in

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unsupported costs), as well as, Indirect Costs and Fringe Benefits amounting to $59,142 (including $7,848 in unsupported costs) and $83,330 (including $40,321 in unsupported costs) for the years ended 1992 and 1991, respectively. The questioned costs included salaries, overheads, office support services & computers, depreciation & supplies, miscellaneous expenses, bank charges, entertainment, travel & per diem, rent, consulting fees and guest reception. Allied Accountants noted weaknesses in EQI's internal controls relating to improper segregation of duties, cash management, reconciliation of payroll records, lack of proper accounting procedures and controls over expenses and payroll, lack of personnel policies and inadequate fixed asset records.

Allied Accountants reviewed EQI's response to the findings. Where applicable they have made adjustments in their reports or provided further clarification of their position.

The following recommendations are included in the Office of the Inspector General's recommendation follow-up system.

> **<u>Recommendation No. 1.1:</u> We recommend that USAID/Egypt resolve questioned costs of $3,688 (including $460 in unsupported costs) for the period May 17, 1992 through May 17, 1993 as detailed on pages 9 through 11 of the audit report.**

> **<u>Recommendation No. 1.2:</u> We recommend that USAID/Egypt resolve questioned indirect cost and fringe benefits for the year ended December 31, 1992 amounting to $59,142 (including $7,848 in unsupported costs) and $83,330 (including $40,321 in unsupported costs) for the year ended December 31, 1991 as detailed on pages 40 through 45 of the audit report.**

This recommendation is considered unresolved and can be resolved when RIG/A/C receives the Mission's formal determination as to the amounts sustained or not sustained. The recommendation can be closed when any amounts determined to be owed to USAID/Egypt are paid by EQI.

> **<u>Recommendation No. 2:</u> We recommend that USAID/Egypt require EQI to address the material internal control weaknesses as detailed on pages 15 through 18 of the audit report.**

This recommendation is considered unresolved and can be resolved when the Mission provides our office with a copy of its request that EQI address its material internal control weaknesses. The recommendation can be closed when RIG/A/C has assessed EQI's response and USAID/Egypt's follow-up for adequacy.

With regard to non-material weaknesses detailed in the "General" findings on pages 18 and 19, these can be handled directly between the Mission and the Grantee.

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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 Allied Accountants and to our office.

Environmental Quality International
Audit of Field Verification and Monitoring of
Human Resources and Development Cooperation
Project Inputs Under USAID/Egypt Contract
No. 263-0000-C-00-2203-00
Fund Accountability Statement
For The Period May 17, 1992 to May 17, 1993
and
Audit of Indirect Cost and Fringe Benefits Rates
For the Years Ended December 31, 1992 and 1991

Environmental Quality International
Audit of Field Verification and Monitoring of
Human Resources and Development Cooperation
Project Inputs Under USAID/Egypt Contract
No. 263-0000-C-00-2203-00
Fund Accountability Statement
For The Period May 17, 1992 to May 17, 1993
and
Audit of Indirect Cost and Fringe Benefit Rates
For the Years Ended December 31, 1992 and 1991

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ALLIED ACCOUNTANTS
Ragheb, Sherif, Istanbouli & El Kilany
A Member Firm of ARTHUR ANDERSEN & Co. SC
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راغب ، شريف ، اسطنبولي والكيلاني
مراسلو آرثر أندرسن وشركاه
محاسبون قانونيون وخبراء تنظيم وادارة
زملاء وأعضاء جمعية المحاسبين والمراجعين المصرية

January 18, 1994.

Mr. Phillipe Darcy
Regional Inspector General for Audit/Cairo
United States Agency for
International Development
Cairo, Egypt

Dear Mr. Darcy:

This report presents the results of our audit of the Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs funded by the United States Agency for International Development Mission in Egypt. Funding is being provided under Contract No. 263-0000-C-00-2203-00 between USAID/Egypt and Environmental Quality International covering the period May 17, 1992 to May 17, 1993. Environmental Quality International (EQI) is to ascertain that nonexpendable property is being utilized for project purposes.

In connection with the audit of the above-mentioned contract we were requested to audit Environmental Quality International's indirect cost and fringe benefits rates for years ended December 31, 1992 and 1991. That report is included as Part II of this report.

Background

Environmental Quality International (EQI) is an Egyptian consulting firm established in 1981. The firm provides environmental and managment consulting services to government and private sector institutions.

Under the contract, Environmental Quality International shall examine the adequacy of GOE internal control systems and monitor the use of nonexpendable property provided by USAID for Egyptian agencies responsible for implementing USAID funded projects. The projects monitored under the contract are those managed by the USAID/Cairo Directorate for Human Resources and Development Cooperation (HRDC) from May 17,1992 to May 17, 1993.

Audit Objectives, Scope and Methodology

The objective of this engagement is to conduct a financial audit of USAID resources managed by Environmental Quality International pursuant to Contract No. 263-0000-C-00-2203-00. The specific objectives of this audit are to:

1. express an opinion on whether the fund accountability statement for the USAID/Egypt financed contract of Environmental Quality International presents fairly, in all material respects, project revenues received and costs incurred for the period under audit in conformity with the applicable accounting principles;

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2. determine whether the direct and indirect costs billed to USAID/Egypt by Environmental Quality International under the contract are in fact allowable, allocable and reasonable in accordance with the terms of the contract (and applicable contract clauses);

3. evaluate and obtain a sufficient understanding of the internal control structure of the organization; assess control risk; and identify reportable conditions, including material internal control weaknesses; and

4. determine whether Environmental Quality International complied, in all material respects, with agreement terms and applicable laws and regulations; and express positive assurance on those items tested and negative assurance on those items not tested. All material instances of noncompliance and all indications of illegal acts should be identified;

The scope of our financial audit was all expenditures incurred under the Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs under USAID/Egypt's Contract No. 263-0000-C-00-2203-00 for the period May 17, 1992 to May 17, 1993.

The methodology of our audit consisted of an internal control evaluation, testing of expenditures incurred under the financing contract and testing compliance by Environmental Quality International with specific contract provisions/requirements and applicable laws and regulations.

Our testing included sampling costs incurred for each budget line item in the contract. We tested LE 589,109 in expenditures from total incurred costs of LE 759,270.

Our testing program included, but was not limited to the following major steps:

1. General ledgers and journals were reconciled to billings submitted to USAID/Egypt.

2. Direct project costs billed to and reimbursed by USAID/Egypt were reviewed.

3. Reviewed the labor distribution reports to assure time billed to USAID was properly documented, approved and allocated.

4. Reviewed procurement procedures to determine that sound commercial practices including competition were used.

We reviewed and evaluated the organization's internal control structure to obtain an understanding of the design of relevant control policies and procedures and whether these policies and procedures have been placed in operation. We obtained a sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing and extent of tests to be performed and we assessed risk.

The contract terms and pertinent laws and regulations applicable to the project were reviewed and audit procedures were designed to test for material noncompliance.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 46 of Chapter 3 of Government Auditing Standards since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

Results of Audit

Fund Accountability Statement

Our audit identified $ 3,688 in questioned costs, including $ 460 in unsupported costs. The details of costs questioned are presented in the Fund Accountability Statement - Audit Findings Section of this report.

Indirect Cost and Fringe Benefits Rates

Our audit determined that indirect cost and fringe benefits rates for the years ended December 31, 1992 and 1991 are:

	1992	1991
Indirect Cost Rate	72.18%	62.68%
Fringe-Benefits Rate	17.09%	15.94%

Our report on the indirect cost and fringe benefits rates is included as Part II of this report.

Internal Control

Our audit identified that Environmental Quality International has not properly segregated accounting duties, checks are frequently issued to "Bearer", petty cash is not controlled/reconciled, fixed asset records are inadequate, personnel/ payroll policies are not in place, labor distribution records are not reconciled to payroll records, accounting records contain mathematical errors, approvals are not obtained prior to procurements being made and charged to projects, there is inadequate control over travel advances, transactions are not always documented and forms are not pre-numbered or controlled.

Also, our audit identified that labor is not properly and consistently allocated, there are no policies in place for hiring and compensating of part-time employees, expenses are not properly classified, financial statements are not reconciled with overhead schedules, there are no subsidiary ledgers for accounts receivable, payables and fixed assets. Not all deposits and bank charges are recorded. Some expenses for salaries and consulting fees are recorded at the net paid rather than at gross salary.

Compliance with Agreement Terms and Applicable Laws and Regulations:

We did not note any noncompliance issues.

Management Comments:

Environmental Quality International responded to the findings in this report. Their comments are included in Appendix B beginning on page 26.

Our comments to their response are included in Appendix C beginning on page 35.

Allied Accountants

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زملاء وأعضاء جمعية المحاسبين والمراجعين المصرية

Mr. Phillipe Darcy
Regional Inspector General for Audit/Cairo
United States Agency for
International Development
Cairo, Egypt

Dear Mr. Darcy:

Independent Auditor's Report

We have audited the fund accountability statement of Environmental Quality International related to project funds received and costs incurred under the Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs under USAID/Egypt Contract No. 263-0000-C-00-2203-00 financed by the US Agency for International Development for the period May 17, 1992 to May 17, 1993. This fund accountability statement is the responsibility of the Environmental Quality International management. Our responsibility is to express an opinion on the fund accountability statement based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatement. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the fund accountability statement. Our audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall fund accountability statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 46 of Chapter 3 of Government Auditing Standards since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

As described in Note 1, the accompanying fund accountability statement was prepared on the cash basis which is a comprehensive basis of accounting other than generally accepted accounting principles.

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Included in the fund accountability statement are questioned costs of $ 3,688 relating to the Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs, USAID/Egypt contract No. 263-0000-C-00-2203-00. The basis for questioning costs are set forth in the Fund Accountability Statement - Audit Findings Section of this report.

In our opinion, except for questioned costs of $ 3,688, the fund accountability statement referred to above presents fairly, in all material respects, Environmental Quality International's project funds received and costs incurred for the Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs, under USAID/Egypt Contract No. 263-0000-C-00-2203-00 for the period May 17, 1992 to May 17, 1993 in conformity with the modified cash basis of accounting described in Note 1.

Our audit was made for the purpose of forming an opinion on the financial statement included in the first paragraph. The supplemental information enclosed in Appendix A is presented for purposes of additional analysis and is not required as a part of the basic financial statement. Such information has been subject to the auditing procedures applied in the audit of the basic financial statement and, in our opinion, is fairly stated in all material respects in relation to the basic financial statement taken as a whole.

This report is intended for the information of the management and others within Environmental Quality International and the US Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

December 20, 1993

Allied Accountants

Environmental Quality International
Audit of Field Verification and Monitoring of
Human Resources and Development Cooperation
Project Inputs Under USAID/Egypt Contract
No. 263-0000-C-00-2203-00
Fund Accountability Statement (Note 1)
For The Period May 17, 1992 to May 17, 1993

			Questioned Cost		
	Budget	Actual	Ineligible	Unsupported	Finding
Receipts:	$	$ 194,108	$	$	
Expenditures:					
Salaries	76,971	73,424	316		1
Fringe benefits	13,393	12,776	55		1
Indirect costs (overhead)	101,207	96,544	415		1
Travel and per diem	19,189	13,752			
Office support services & computers	3,063	3,615	633		2
Transportation	15,618	13,008	680		3
Four note book PCs-depreciation and supplies	4,324	3,003	937	460	2,4
Fixed fee	12,857	11,887	192		(1)
	246,622	228,009	3,228	460	
Net balance		(33,901)	3,688		

(1) The $ 192 of questioned cost under fixed fee is a calculated amount based on 5.5% (contract approved percentage) of $ 3,496 questioned costs.

See accompanying notes to the fund accountability statement.

Environmental Quality International
Notes to the Fund Accountability Statement

Note 1 : Basis of Presentation

The indirect cost and fringe benefit rate schedules have been prepared on the modified cash basis which includes cash receipts and disbursements plus depreciation. Consequently, receipts and expenditures are recognized when received or paid rather than when earned or incurred.

Note 2 : Project Activities

The contract provides funds for the examination of the Government of Egypt internal control systems and to monitor the use of nonexpendable property provided by USAID to Egyptian agencies responsible for implementing USAID/Egypt projects. The expenses to be funded under the contract are salaries, fringe benefits, travel and per diem, transportation, office support services, overhead, and fixed fee.

Note 3 : Net Balance

The net balance of $ (33,901) on the fund accountability statement represents the invoices for April and May 93 paid by USAID/Egypt after May 17, 1993.

Note 4 : Exchange Rate

Expenditures incurred in local currency (LE) have been converted into US$ at an average exchange rate of LE 3.33/US$.

Note 5 : Questioned Cost

Incurred questioned costs are presented in two categories: ineligible and unsupported costs. Questioned costs are those expenditures we have determined not to be in accordance with the project contract and other applicable USAID/Egypt regulations or because they are not supported with adequate documentation. "Ineligible" costs are deemed to be unallowable because they are prohibited by the contract or USAID/Egypt regulations/policies. These costs are supported by adequate documentation. "Unsupported" costs are expenditures which are not supported by adequate documentation or were not authorized/approved by the proper officials.

The basis or reason for questioning specific costs are set forth in the "Audit Findings Section" of this report.

Environmental Quality International
Fund Accountability Statement

Audit Findings Section

Finding 1 - Salaries

Condition:

During the period under audit EQI overbilled USAID/Egypt salaries in the amount of LE 1,052. As stated per contract, 17.4% of salaries is billed for fringe benefits and 112% for overhead applied to salaries and fringe benefits. Total amount questioned is :

Date	Check No.	Amount
May, 92	437358	LE 76
May, 92	434749	37
Aug., 92	285390	19
Aug., 92	285369	88
April, 93	321300	412
May, 93	870460	420
		1,052

Salaries	LE 1,052	$ 316
Fringe benefits	183	55
Overhead	1,383	415
		$ 786

Criteria:

Salaries billed to USAID/Egypt should be based on actual daily rates. Section G.4 of the contract requires Environmental Quality International to keep accurate written account of costs.

Cause:

For two employees the rate used for billing purposes was that of former employees whose daily rate was higher. For the rest, the labor distribution rates were incorrect and, because of the lack of a reconciliation between payroll, labor distribution and salaries billed to USAID/Egypt, differences were not detected.

Effect:

USAID/Egypt was overbilled for salaries plus fringe benefits and overhead in the amount of LE 2,618 (US$ 786).

Finding 2 : Office Support Services and Computers

Condition:

Depreciation billed to USAID/Egypt for EQI's own computers and a laser printer, used for the HRDC Project, was computed using a 33.33% rate while for accounting purposes depreciation was calculated at 20%. The amount billed for depreciation is detailed as follows:

	Office Support Services	Four Note Book PCs
Amount billed (33%)	LE 5,274	LE 7,804
Normal EQI rate (20%)	3,165	4,682
Difference	2,109	3,122
	$ 633	$ 937

Criteria:

The contract provisions allow EQI to charge depreciation on its own computer equipment, however, according to the Federal Acquisition Regulations, Part 31 - Contract Cost Principles and Procedures, Section 31.205-11 allowable depreciation should not exceed the amounts used for book and statement purposes and depreciation should be consistent with those policies and procedures in the same cost center for businesses other than government.

Cause:

The Finance Director indicated that the percentage used for billing was verbally recommended by the predecessor external auditors.

Effect:

As per the contract, the budget approved depreciation, however, EQI billed to USAID/Egypt ineligible depreciation in the amount of $ 633 for office support services and $ 937 for computer.

Finding 3 : Transportation

Condition :

EQI billed USAID/Egypt LE 2,266 (US$ 680) for depreciation of two vehicles which as of May 17, 1992 were fully depreciated.

Criteria:

Federal Acquisition Regulations, Part 31 - Contract Cost Principles and Procedures, Section 31-205-11 states that no depreciation or rental shall be allowed on property fully depreciated.

Cause:

Because the budget permitted depreciation for vehicles used in the project, EQI billed the above amount without taking into consideration that they were already fully depreciated.

Effect:

Ineligible expense of $ 680 under the contract was billed to USAID/Egypt.

Finding 4 : Four Note Book PC's - Depreciation/Supplies

Condition:

Purchase of computer diskettes were not approved by the Project Director, no purchase order was issued and supporting documentation is not sufficient to determine whether they were used for the project. Also, the amount of diskettes purchased (300) seems to be unreasonable as 300 diskettes is equivalent to 575 reams of paper.

Date	Check #	Amount
11/03/93	317641	LE 523
09/15/92	291586	1,008
		1,531
		$ 460

Criteria:

Expenses billed to the project should be reasonable and allocable. Supporting documentation should show evidence that expenses were approved and used for the project.

Cause:

The Project Director did not approve all costs charged to the project.

Effect:

Unsupported and unreasonable expenses of $ 460 were billed to USAID/Egypt.

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Mr. Phillipe Darcy
Regional Inspector General for Audit/Cairo
United States Agency for
International Development
Cairo, Egypt

Independent Auditor's Report
Report on Internal Control Structure

We have audited the fund accountability statement of Environmental Quality International related to the Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs, under USAID/Egypt's Contract No. 263-0000-C-00-2203-00, financed by the US Agency for International Development, for the period May 17, 1992 to May 17, 1993, and the indirect cost and fringe benefits rates schedules for the years ended December 31, 1992 and 1991 and we have issued our reports thereon dated December 20, 1993.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement and the indirect cost and fringe benefits schedules are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 46 of Chapter 3 of Government Auditing Standards since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

In planning and performing our audit of Environmental Quality International, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the fund accountability statement and the indirect cost and fringe benefits schedules and not to provide assurance on the internal control structure.

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The management of Environmental Quality International 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 the assets are safeguarded 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 the fund accountability statement and the indirect cost and fringe benefits schedules in accordance with the cash basis of accounting described in Note 1 to the Fund Accountability Statement and the indirect cost and fringe benefit schedules. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection 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 have classified the significant internal control structure policies and procedures as being: cash receipts, cash disbursements, payroll, fixed assets, allocation of indirect and direct costs, financial reporting and procurement. For the control categories listed above, 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 reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgement, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more specific 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 fund accountability statement and the indirect cost and fringe benefits schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our audit disclosed the following matters which we believe are material weaknesses as defined above.

Environmental Quality International has not dispersed accounting duties in a manner to properly segregate duties, checks are frequently issued to "Bearer", petty cash is not controlled/reconciled, fixed asset records are inadequate, personnel/payroll policies are not in place, labor distribution records are not reconciled to payroll records, accounting records contain mathematical errors, approvals are not obtained prior to procurements being made and charged to projects, there is inadequate control over travel advances, transactions are not always documented and forms are not pre-numbered or controlled.

Also, our audit identified that labor is not properly and consistently allocated, there are nc policies in place for hiring and compensating of part-time employees, expenses are noı properly classified, financial statements are not reconciled with overhead schedules, there are no subsidiary ledgers for accounts receivabe, payables and fixed assets. Not all deposits and bank charges are recorded. Some expenses for salaries and consulting fees are recorded at the net paid rather than at gross salary.

This report is intended for the information of the management and others within Environmental Quality International and the US Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

December 20, 1993

Official Accountants

Environmental Quality International
Internal Control

Audit Findings Section

Cash Management

A. Cash in bank

Staff who are authorized to sign checks and are in charge of petty cash are not covered by fidelity bond insurance.

EQI accounting staff write and sign checks made payable to "Bearer". Many of these checks involve amounts of several thousand LE.

B. Petty cash

The petty cash fund is not maintained on an imprest basis nor is there a fixed amount. The petty cash register is not updated daily, therefore, the custodian does not know how much is available in petty cash. Also, funds unused from travel advances are put into the fund and no documentation is prepared. Frequently, expenses are paid partially by check and partially by petty cash without documentation.

We observed that the custodians of petty cash keep funds in their desk and the safe. Petty cash is not properly safeguarded and accounted for.

Recommendation

We recommend that Environmental Quality International obtain fidelity bond coverage for employees who are authorized check signers. Also, to strengthen internal control Environmental Quality International should refrain from writing checks to "Bearer".

Furthermore, we recommend Environmental Quality International establish an imprest petty cash fund and implement a receipt/voucher system to document activity in the fund. Surprise petty cash counts should be performed to assure integrity of the fund.

Fixed Assets

There are inadequate controls over fixed assets. Environmental Quality International does not have subsidiary asset records. The only record is a work sheet where asset additions are listed as paid without description of the asset, check , invoices, location, etc. These work sheets sometimes indicate that assets were sold but they are still included in the financial statements. The physical inventory, performed in 1992, did not segregate the assets by categories i.e. furniture, computers, etc. For some items an estimated amount was assigned, but the Finance Department did not have a copy of this inventory.

According to the Finance Director, fixed assets are capitalized when their estimated life is over one year and there is no minimum amount stated to be capitalized but the accounting manual states that office equipment with acquisition cost under LE 100 should be expended.

Environmental Quality International billed USAID depreciation for vehicles that were fully depreciated and the depreciation for computers at a 33% rate while for accounting purposes it was computed using a rate of 20%.

Recommendation

We recommend that EQI establish policies related to fixed asset accounting and that a fixed asset register be established to track asset cost, identification and use.

Personnel

Environmental Quality International did not develop a "Personnel Policies and Procedures Manual" until January 1993. As noted during our audit, the Finance Department was not aware of the manual. The Finance Department administers certain aspects of personnel matters such as salary payments, time sheets and leave accounting.

Personnel files do not have adequate documentation supporting salary rates/salary increases. Some contracts were signed for the net salary. Salary increases were not documented in writing until January 1993 and these documents indicate the increase as a percentage with no indication of the new salary resulting from the increase. The salary history report, a form that seems to have been recently prepared for each employee, contains many mistakes, e.g. the beginning salary does not agree with contract. When some employees did not work the full month they were paid for the actual time worked, this difference was reported as a salary decrease on this form.

The Personnel Policies and Procedures Manual does not state minimum and maximum percentages for salary increases or how the percentages are to be determined. Salary increases granted could range from 3% to 50%. Even though the manual states that salary increases will be granted annually, some employees have received more than one annual salary increase. For some employees the salary increase amount was miscalculated.

EQI does not have a personnel policy for part-time staff. Some staff do not have contracts and others have a "letter of assignment". This document does not fully describe employee duties and responsibilities, period of assignment and in some cases the amount to be paid. In addition, some employees working as full-timers will receive payments as part-timers or switch from part-timers to full-timers. We noted payments to some employees recorded under consulting fees and consultant payments recorded as salaries. The part-timers' income tax is computed as if they were consultants which is less than the amount calculated for full-time employees.

Recommendation

We recommend the management of EQI distribute a copy of the manual to all employees and that the Finance Department be required to adhere to the policies/procedures established.

EQI needs to establish policies related to the hiring of part-time employees. At the least, these policies should indicate under which circumstances an employee is considered a part-timer, maximum hours to be paid for a part-timer, method and base of payment, and the contract to be signed.

Payroll

Environmental Quality International does not keep payroll registers for the allocation of salaries. The checks issued for the payment of salaries are not itemized nor does the record identify the check numbers and dates.

Office boys and drivers are not included in the labor distribution reports. Payroll is not reconciled with the labor distribution report nor is the labor distribution report reconciled with salaries billed to projects.

Some of the differences noted between the payroll and labor distribution were because the hourly rate was miscalculated, some employees were overlooked, or the hours/time allocated did not agree with the actual time sheet. The labor distribution has corrections in pencil and there is no written evidence that these changes, nor the payroll and labor distribution report, have been reviewed and approved.

For some employees, time sheets were not approved and signed by the supervisors. Division heads and project officers' time sheets are not approved by their immediate supervisors.

For labor distribution purposes EQI allocates salaries on a fixed number of hours per month (173.33). When the actual hours exceed this fixed factor the variance is inconsistently allocated to direct or indirect cost, but when the actual hours are less than the fixed factor the variance is allocated to a category termed "less time" which is improperly allocated to fringe benefits. Also, it is EQI's policy that direct salaries which are not billed to projects are to be allocated as indirect.

Time sheets are not properly prepared. EQI only pays full-time employees for eight hours five days a week, yet some employees report more than eight hours per day and more than five days a week. Time sheets are sometimes prepared in pencil, or red ink, with many cross outs and alterations. In other instances, employees report less than eight hours and they still get paid for the full day.

We noted several miscalculations in social insurance and payroll taxes. All personnel files do not have the social insurance form as required by the social insurance law.

For four part-time employees selected in our testing, EQI provided us with documents that apparently were prepared as a result of our audit. Three of these documents were not dated, printed on paper EQI letterhead and approved by a department head. The person approving these documents started working for EQI in September 92 and one of the employees tested was already working in July 92. A third document provided by EQI was to support payments made in May 91 and this document is dated November 23, 1993.

Recommendation

We recommend that Environmental Quality International review its procedures for processing payroll/labor distribution and implement modifications necessary to enhance the system's accuracy and effectiveness.

Furthermore, we recommend EQI ensure that salaries are allocated based on the time sheets. Time sheets should be properly filled out by employees and approved by their supervisors promptly upon completion.

Ledger Journals

The accounting records for 1991 and 1992 consist of two disbursement journals for direct and indirect costs. Neither book includes payroll allocations or payments. EQI did not maintain a general ledger to summarize accounting transactions for cash and non-cash entries. The payroll registers and labor distribution records are not integrated nor are labor allocations between direct/indirect costs in agreement with the time sheets. During our audit, EQI's staff recalculated labor distribution at our request as the original allocation contained numerous errors. The system is a single entry system and reconciliations between various records are not made on a monthly basis.

In January 1993, EQI began implementing an automated system to be maintained on the accrual basis. As of our audit a trial balance for January had been prepared but the staff were still in the process of reconciling it to the manual records. We could not locate any written evidence that the manual records have been reconciled with the automated system reports.

General

There is inadequate segregation of duties in the Finance Department. The Finance Director and the Assistant Finance Director have authorized check signatures. The Finance Director prepares the payroll checks and the accountant who prepares the payroll distributes the checks to employees and currently posts the payroll allocation in the computerized accounting system. The accountant in charge of accounts payable prepares the checks, posts transactions and mails checks to vendors. In addition, the Assistant Finance Director prepares receipts for deposits and bank reconciliations.

Travel advances are expended when issued instead of recording them as accounts receivable and liquidating them when the report is submitted.

Purchase orders are not issued even though the accounting manual requires that for the acquisition of goods and services over LE 300 purchase orders should be issued.

Billings to projects are not reconciled with existing records.

The division heads or project officers do not approve the expenses charged to their projects.

The expenses, both direct and indirect, are not properly classified. Direct expenses are recorded as indirect, or expenses are recorded to incorrect expense categories. Because of inconsistencies in preparing the overhead schedule, the Assistant Finance Director had to completely re-analyze 1991 and 1992 expenses, resulting in a substantial number of reclassifications. In some instances, in a single expense category there were multiple reclassification entries or entries that were not recorded in the books. However, a reconciliation was not completed to assure the integrity of the financial data. In our reconciliation of expenses per financial statements with the overhead schedule we noted differences that EQI could not explain.

EQI does not keep a subsidiary ledger for the control of social security withholdings for employees and employer's share and payments. During 1991 and 1992 EQI paid social security on behalf of another company (DCG). Payments were reimbursed by DCG and deposited in EQI's bank account, but no entry was made to record the reimbursement. The expenses for social security reported in the financial statements include the payments reimbursed by DCG.

EQI prepares a monthly "bank register" where all deposits received, checks issued and bank charges are recorded. These schedules are reconciled with the bank statements. However, we noticed that deposits for the reimbursement of expenses were not recorded in the journals. Therefore, credits were not shown in the financial statements. Also, some entries for expenses and bank charges contain mistakes which were never corrected.

The financial statements as of December 31,1992 include LE 136,913 for accrued expenses but the expenses per financial statements are based on cash expenses plus depreciation expenses. The salary expenses for CIDA and LD II projects were recorded at the net paid. When inquiring about inconsistencies, we were informed that the financial statements are prepared by an outside accounting firm and EQI does not keep a ledger or worksheet to support the figures in the financial statements.

Also, during our testing we noted one instance where a check was written and the expense posted but the check was still in the files. The check was signed but the payee was not indicated on the check. After we asked for an explanation. EQI's accountant wrote the beneficiary's name on it.

None of the internal forms such as purchase orders, cash receipts, petty cash vouchers, disbursement vouchers, journal vouchers, etc. are pre-numbered.

Supporting documentation for cash and check disbursements are not stamped when paid and consequently, the check number is not identified on the supporting documentation.

Recommendation

We recommend that Environmental Quality International conduct a thorough assessment of its general accounting system and procedures to strengthen the internal control structure and enhance the accountability of Environmental Quality International's financial resources. The resultant system and procedures should be documented.

We recommend that the Finance Department ensure that all transactions are recorded. Transactions should have written evidence of being reviewed, approved and properly classified. Subsidiary records for accounts receivable, banks, fixed assets and accounts payable should be implemented and reconciled on a monthly basis with the general ledger. Also, the financial statements should be prepared from the general ledger.

Environmental Quality International

Follow-up of Prior Audit
Recommendations

In presenting our follow-up evaluation of recommendations made in the prior audit for the period January 1, 1988 to December 31,1990, we have detailed herein the original findings and recommendations. Our evaluation of EQI's implementation of the recommendations is noted as "Arthur Andersen & Co. Follow-up Evaluation".

1. Inadequate control over billing procedures:

Our audit disclosed many deficiencies in EQI's billing procedures which ied to questionable costs. Such costs were the result of billing procedures that were based on estimates, budgets and incorrectly calculated labor rates rather than on actual costs. EQI's billing procedures were not based on project subsidiary ledgers, and did not allow for the required accounting adjustments in allocating and charging actual costs incurred, and in reconciling billed costs with reimbursed costs.

Recommendation (1)

We recommend that EQI:

- review the entire billing process and redesign it based on actual costs recorded.
- use the 260 working days a year as a standard to establish the billing rates for administrative personnel and for professional field staff.
- reconcile the monthly hours billed with the actual hours recorded and approved in every individual time sheet.
- maintain a biographical data sheet for every staff member showing his/her earnings history; a copy should be filed with each project proposal.

Arthur Andersen & Co. Follow-up Evaluation:

- The recommendation for redesigning the billing process has been partially implemented. Charges for depreciation and use of EQI's cars are still based on estimations.
- EQI implemented the use of 260 working days for billing rates but it is not being used consistently.
- The recommendation on reconciliation of monthly hours billed to actual hours recorded has not been implemented.
- EQI implemented a form "salary history report" to show employee earnings history, but we noted that this form has errors and inconsistencies and for some employees the form did not exist. The personnel files do not have biographical data sheets.

2. Inadequate accounting procedures

EQI overbooked travel and per diem costs charged to LDII, PVO - DAC. EQI paid advances to its employees and then directly charged them to the project account, irrespective of actual costs incurred. We were not able to reconcile verified travel and per diem documents with the monthly invoices EQI submitted to DAC due to overbooking and lack of control over documentation. There was no reference to tie supporting documents with the invoices or to match advances paid with the relevant supporting bills. Accordingly, risk of double counting costs existed. Additionally, it was difficult to verify proper settlement of advances by reconciling between advances and the related incurred expenses because of the large number of supporting documents filed without reference to bills or cross-reference to advance checks.

Recommendation (2)

We recommend that EQI design and implement a filing system that facilitates the monthly billing process. In addition, EQI should conduct a monthly reconciliation to ensure accuracy and correctness.

Arthur Andersen & Co. Follow-up Evaluation:

EQI implemented a filing system of expenses for each project, but still there is no evidence that billings were reconciled with records.

3. Lack of supporting documents to financial transactions:

EQI's direct costs charged to projects included instances of inadequate supporting documents. Furthermore, our audit revealed that more than 7% of the total costs audited during the three years ending December 1990, lacked proper supporting documents due to overbooking, double counting, documents addressed to entities other than EQI and the absence of supporting documents.

Recommendation (3)

We recommend that EQI design and implement a system that ensures proper documentation for procurement and disbursement transactions.

Arthur Andersen & Co. Follow-up Evaluation:

We did not note overbooking, double accounting or documents that were not addressed to EQI, but EQI's expenses include unsupported expenses.

4. Inadequate control procedures over certain disbursements:

Our review revealed that EQI did not maintain logs to control and allocate the following items:

- International long distance calls and couriers.
- Motor vehicle operating expenses.
- Office equipment operating expenses.
- EQI's Managing Directors' expenses.

Although we do not question the reasonability of such costs, material errors could occur and not be detected or corrected. Susceptibility of overbooking, double counting, misclassification of direct costs as indirect costs and defalcation of EQI's resources are possible. Accordingly, the quality of control over the aforementioned costs is questioned.

Recommendation (4)

We recommend that EQI maintain proper logs and follow appropriate accounting procedures in recording cash disbursements and for allocation of incurred costs.

Arthur Andersen & Co. Follow-up Evaluation:

EQI had implemented the use of logs for international long distance calls and couriers, and vehicle use but not for office equipment operating expenses and there is inadequate control of the cash disbursements and allocation of costs.

5. Inadequate bookkeeping procedures:

EQI does not maintain a cash register for foreign currency transactions. Foreign currency transactions are converted into LE and recorded in the journal/records as LE expenses. Foreign currency bank statements are not reconciled in a timely manner. In addition, project subsidiary ledgers are not maintained according to their functional currency. Project transactions are recorded as incurred in LE. This method of recording does not permit proper and timely reconciliation of project's cost incurred with cost reimbursed.

Recommendation (5)

We recommend that EQI maintain a foreign currency register and conduct a monthly bank reconciliation. In addition, another monthly reconciliation should be made between costs incurred in LE converted at the current rate of exchange with costs reimbursed in the project's functional currency.

Arthur Andersen & Co. Follow-up Evaluation:

EQI prepares a monthly schedule called the bank register where transactions are converted into LE at the prevailing rate and this schedule is reconciled with the bank statement. EQI does not keep subsidiary ledgers or a general ledger; therefore, this reconciliation is not compared with the books. Furthermore, we noted that some deposits are not recorded and there were some mistakes when recording disbursements and bank charges.

ALLIED ACCOUNTANTS
Ragheb, Sherif, Istanbouli & El Kilany
A Member Firm of ARTHUR ANDERSEN & Co. SC
Public Accountants &Business Advisors
Fellows & Members of the Egyptian Society of Accountants & Auditors

المحاسبون المتضامنون
راغب ، شريف ، اسطنبولي والكيلاني
مراسلو آرثر أندرسن وشركاه
محاسبون قانونيون وخبراء تنظيم وادارة
زملاء وأعضاء جمعية المحاسبين والمراجعين المصرية

Mr. Philippe Darcy
Regional Inspector General for Audit/Cairo
United States Agency for
International Development
Cairo, Egypt

Independent Auditor's Report
Report on Compliance With Agreement Terms
and Applicable Laws and Regulations

We have audited the fund accountability statement of Environmental Quality International related to the Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs, under USAID/Egypt Contract No. 263-0000-C-00-2203-00, financed by the US Agency for International Development for the period May 17, 1992 to May 17, 1993 and the indirect cost and fringe benefits rate schedules for the years ended December 31, 1992 and 1991, and we have issued our reports thereon dated December 20, 1993.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement and the indirect cost and fringe benefits rate schedules are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 46 of Chapter 3 of Government Auditing Standards since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

Compliance with laws, regulations, contracts, and binding policies and procedures applicable to Environmental Quality International is the responsibility of Environmental Quality International's management. As part of our audit, we performed tests of Environmental Quality International's compliance with certain provisions of laws, regulations, contracts, and binding policies and procedures. However, it should be noted that we performed those tests of compliance as part of obtaining reasonable assurance about whether the fund accountability statement and the indirect cost and fringe benefits rates schedules are free of material misstatement; our objective was not to provide an opinion on compliance with such provisions.

العنوان : ٣٧ شارع الأحرار ، برج موبيكا ، المهندسين - ص. ب. ٩٧ الدقي ، جيزة ، مصر تليفون : ٣٦٠٨١١١ فاكس : ٣٦٠٠٨١٣
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The result of our tests indicate that with respect to the items tested, Environmental Quality International complied, in all material respects, with the provisions referred to in the fourth paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that Environmental Quality International had not complied, in all material respects, with those provisions.

This report is intended for the information of management and others within Environmental Quality International and the US Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

December 20, 1993

Allied Accountants

APPENDICES

Appendix A

Environmental Quality International
Audit of Field Verification and Monitoring of
Human Resources and Development Cooperation
Project Inputs Under USAID/Egypt Contract
No. 263-0000-C-00-2203-00
Fund Accountability Statement
For The Period May 17, 1992 to May 17, 1993

Supplemental Information
Fund Accountability Statement Presented
in Egyptian Pounds and US Dollars

	Actual in LE	LE converted to US$
Receipts:	LE 646,378	$ 194,108
Expenditures:		
Salaries	244,502	73,424
Fringe benefits	42,543	12,776
Indirect costs (overhead)	321,491	96,544
Travel and per diem	45,796	13,752
Office support services & computers	12,040	3,615
Transportation	43,316	13,008
Four note book PC's-depreciation and supplies	9,999	3,003
Fixed fee	39,583	11,887
	759,270	228,009
Net balance	(112,892)	(33,901)

Conversion made at LE 3.33/$.

ENVIRONMENTAL
QUALITY
INTERNATIONAL

April 7, 1994

Mr. Eugene E. Smith
Allied Accountants
37 El Ahrar Street
Mohandessine, Cairo

Dear Mr. Smith,

Attached please find EQI's response to the audit of Indirect Cost and Fringe Benefit Rates for the Field Verification and Monitoring of Human Resources and Development Cooperation Project, USAID/Egypt Contract No. 263-0000-C-00-2203-00, covering the years ended December 31, 1991 and 1992.

Yours sincerely,

Ahmed Bahgat
Project Manager

cc: Mr. Syed Ali - FM/AM
Mr. Jim Garen - RIG/A
Mr. Mr. Duncan Miller - AD/HRDC
Mr. Leonel Pizarro - DIR/CS

3B, Bahgat Ali Street, Zamalek, Cairo, Egypt Tel: 3408284 - 3400052 Tlx: 23172 NAOOM UN Fax: 3413331

FUND ACCOUNTABILITY STATEMENT

AUDIT FINDINGS SECTION

We would like to respond to certain points that were raised in the audit finding:

Finding 1: Salaries p. 9

We agree with the finding that EQI overbilled for certain individuals. We would, however, like to clarify the following:

- With regard to cheques # 437358 and No. 285390 amounting to L.E. 76 and L.E. 19, respectively, the differences resulted from payroll computation based on the salaries' being calculated as a fraction of a calendar month (30 days), while the billing rate was calculated by dividing the gross sa[illegible] 21.67 days.

- With regard to cheque # 285689 for L.E. 86, this difference was a result of our including the housing allowance of L.E. 950 per month in the gross monthly salary to reach a total of L.E. 3000, while the auditors classified this allowance under fringe benefits.

- Concerning cheques # 321300 for L.E. 412, and cheque No. 870460 for L.E. 420, the mistake arose because the original team members in each of these cases were replaced by others at lower salaries. The necessary adjustments were not made at the exact time of the substitution.

- With regard to cheque No. 434749 for L.E. 37, the difference was the result of a mathematical error.

Finding 2: Office Support Services & Computers - p. 10

Concerning the depreciation of the computers and laser printer being calculated at 20% for accounting purposes while billed to USAID at a 33.33% rate, we did indeed state the rate at 20% in our books, since they are prepared solely for tax purposes, in compliance with Tax Law 157/1991. However, as a result of KPMG Hazem Hassan's audit 1988/1990, we were advised to apply a depreciation rate of 33.33% for computers, owing to the rapid changes in technology in this field which render such equipment obsolete in a very short time. We applied this rate accordingly, and request that it be considered eligible.

Finding 3: Transportation - p. 10

With regard to the amount charged for depreciation of vehicles, the term "depreciation" was a simple misnomer. In accordance with FAR regulation No. 31.109h2, which states that "a reasonable charge for using fully depreciated property may be agreed upon", EQI is entitled to charge for fully depreciated vehicles.

Accordingly, the L.E. 2266 billed over a period of 12 months and amounting to a daily billing rate of L.E. 8.71 or $2.62 per day, constitutes the sum charged to the project for use of a fully depreciated vehicle. We believe this charge to be exceedingly low. See Attachment 1. In view of the above, we request that the amount be considered eligible.

Finding 4: <u>Four Note Book PC's - Depreciation/Supplies</u> p. 11

The number of diskettes used by EQI has been described as excessive; however, we would like to point out that thirty boxes were consumed for the six computers allocated to the HRDC project. This means five boxes for every computer over a period of one year. As for the Project Manager's not approving every supporting documentation, we would like to point out that the Project Manager reviews all supporting documentation included in the billing package attached to each monthly invoice, and signs the billing package certificate every month. His endorsement of the certification constitutes a tacit approval of all documents included in the package. As for the two invoices in question, although they were not initialed by the Project Manager, they were reviewed by him and personally marked "HRDC" for proper allocation by the Accounting Department. See Attachment 2. Given the above rationale, we consider the charges to be reasonable, and request that they be considered eligible.

INTERNAL CONTROL

AUDIT FINDINGS SECTION

1: Cash Management p. 15

A. Cash in Bank

Fidelity bond insurance coverage will be obtained for EQI staff responsible for handling cash. The issuance of checks made payable to "bearer" ceased in 1993.

B. Petty Cash

Imprest basis in petty cash will be implemented. The petty cash register is updated daily. The backlog that developed during the audit phase was due to the accountant in charge being occupied with the auditors for an extended period of time. Since then, the situation has gone back to normal and the petty cash is updated daily. Funds unused from travel advances are supported with documentation and recorded in the register.

EQI maintains its petty cash fund in the safe. A small portion of cash not to exceed LE 200 is kept in a petty cash box in the accountant's desk during the day. The unused portion and documents are returned to the safe at the end of the working day. This is because the main safe combination is only known to the Finance Director and her assistant.

2: Fixed Assets: p. 15

EQI established and implemented fixed asset accounting policies and procedures starting January 1, 1993. All fixed assets data and information are properly maintained and controlled through our new automated accounting system. Periodical physical count by category is performed and reconciled with accounting records. Please refer to KPMG Hazem Hassan's certification dated March 1, 1994.

3: Personnel: p. 16

Personnel Policies and Procedures Manual:
The Finance Department is not responsible for personnel matters, which are the responsibility of the Administration Department. The auditors were referred to the Administration Department, and a copy of the Personnel Policies and Procedures Manual was presented to them. EQI's Manual was distributed to all employees in March, 1993 and was posted on the bulletin board for 30 days. Since then, the Finance Department has been adhering to the policies and procedures established.

As stated in the draft audit report, personnel policies and procedures were implemented in January, 1993. Since then, personnel files have been reviewed to ensure the inclusion of all required forms, such as salary rates and percentage of increase. Finally, EQI updates the Personnel Policies & Procedures Manual regularly to ensure coverage of different organizational requirements, as they occur.

Salary Increases:
As of January 1993, EQI's Management Committee of five senior staff has been responsible for staff evaluation. The committee convenes to grant staff members their annual increase, which may not exceed 20%. Any increase over that percentage represents salary adjustment, which by definition can take place any time during the year.

Part-Time Staff:
Employees assigned or contracted to work for under 40 hours per week or for a fixed duration of time (temporary assignment) are considered to be part-timers or outside consultants, as the case may be, and are issued letters of assignment. Their duties and responsibilities are specified in the Terms of Reference of the related project. Prior to 1993, letters of assignment were not always prepared because the system was not yet fully installed. With the new system in place, the status of the various employees has been reviewed to ensure that accounting records and tax computations are accurate, and corrections have been made when necessary.

4: <u>Payroll:</u> p. 17

Payroll Registers:
Payroll distribution sheets are available to detail allocation to various projects. Checks issued for the payment of salaries are posted in the check register, which shows the check date, check number, payee and amount.

Labor Distribution of Office Boys and Drivers:
Moreover, prior to 1993, office boys and drivers were not required to submit time sheets. Their actual salary costs were added to the payroll distribution sheets for reconciliation purposes.

Payroll Reconciliation:
Prior to 1993, although written reconciliations were not prepared, accountants were responsible for double checking figures, as well as noting and analyzing differences on the distribution sheet. For example, because EQI applies neither an overtime nor a compensatory time system, staff time exceeding the maximum standard time is disregarded. Finally, since January 1993, all time sheets are reviewed, signed and approved by responsible staff as appropriate.

Less Time:
As for the allocation of "less time", the purpose of applying this procedure is to arrive at the maximum standard time allowed to calculate the actual billing rates.The Work in Progress System (WIP) was implemented effective January 1, 1993. This allows the allocation of all chargeable time to be recorded as direct cost or written off if not billed.

Time Sheet Preparation:
Time sheets are recorded on an actual basis. It is necessary for the employees to record their actual time for reasons other than overtime payments, such as to claim per diems requiring a working day of 10 hours or more. In January, 1993, employees were instructed and briefed on popular errors made among the staff in filling out their time sheets such as using red ink or pencil and not initialing cross-outs and alterations. Project Managers and Department Heads currently review and approve all time sheets.

Personnel Files:
As previously mentioned with the introduction of the new system in January, 1993, personnel files have been reviewed for completeness.

5: <u>Ledger Journals:</u> p. 18

Our newly implemented accounting system allows for proper and accurate recording and reporting of accounting transaction. The accrual basis of accounting is being followed. Please refer to KPMG Hazem Hassan certification dated March 1, 1994, commenting on the system design and implementation.

6: <u>General:</u> p. 18

Segregation of Duties:
Proper segregation of duties has not always been possible because of the limited number of staff members in the Accounting Department. Moreover, during the audit, the accountant in charge of payroll checks had resigned and her duties had not yet been assigned to her replacement. As for the authorized check signors, two signatures are required on each check.

Travel Advances:
Effective January, 1993, travel advances are only expended when settled.

Purchase Orders:
Purchase Orders, Purchase Requisition and Goods Receiving Reports are properly prepared to support payments for goods and services.

Billing Reconciliation:
The Work in Progress System (WIP), has been in effect since January 1, 1993, which ensures proper reconciliation and billings of various project costs.

Approval of Project Expenses:
Approvals and proper accounts classifications have been observed since the implementation of the new accounting system.

Expense Classification:
During 1991 and 1992, the double entry system of accounting was not applied. The accounting books and records were only kept for statutory and tax purpose and therefore transactions not affecting these records were disregarded. The auditors were informed that the books were prepared for tax department purposes only.

Social Security Withholdings:
A subsidiary ledger is not needed to control social security withholdings for employees and employer's share and payments. Amounts payable to the Social Security Organization are calculated on the monthly payroll sheet.

Financial Statements:
EQI started to implement an automated accounting system as of January 1, 1993 and converted from cash to accrual basis. In order to have adequate beginning balances (opening balance sheet for 1993) adjustments were made to the 1992 financial statements. In addition, further adjustments were made to correct the beginning balances to reflect all payables, receivables, and work in progress.

Check in File:
Due to the fact that the beneficiary's full name was not known to the accountant at the time, the accountant was advised to safeguard the check for the beneficiary for same day collection. The beneficiary never showed up and the check was kept in a safe.

Prenumbered Forms:
Since 1993, Journal vouchers have been numbered and supporting documents stamped {PAID}. Other pre-numbered forms such as Purchase Orders, Cash Receipts, Petty Cash Vouchers and Payment Vouchers are currently being printed.

FOLLOW-UP OF PRIOR AUDIT

RECOMMENDATIONS

We would like to point out that KPMG Hazem Hassan conducted an audit of EQI in 1992, for 1988 - 1990. In October 1992, EQI received the auditor's final report (# 6-263-93-01-N) with recommendations for internal control improvements. In response to these recommendations, EQI designed a new accounting system that has been operational since January 1993. The Arthur Anderson audit of EQI in September 1993 covered 1991 and 1992, both of which are years that precede the KPMG Hazem Hassan recommendations. A brief response to the above-mentioned recommendations is presented below.

1. **Inadequate control over billing procedures:** **p. 20**

   - The newly designed Work-In-Progress (WIP) System is now fully operational.
   - Billing rates are now accurately and consistently calculated.
   - Reconciliation between actual costs recorded and costs billed are prepared, over and under records are posted to Work-In-Progress (WIP) system.
   - Biodata sheets are maintained on the central files of EQI.
   - The form "Salary History Report" is prepared for EQI's internal use. The form was not a recommendation in the KPMG Audit report, nor is it required by prevailing Egyptian regulations.

2. **Inadequate accounting procedures:** **p. 21**

   Refer to the response under Recommendation (1).

3. **Lack of supporting documents to financial transactions:** **p. 21**

   In some instances, supporting documents are insufficient due to the fact that the beneficiary avoids documentation for tax purposes. Steps are currently being taken to avoid dealing with vendors and/or consultants who do not have a tax card number.

4. **Inadequate control procedures over certain disbursements:** **p. 21**

   EQI already maintains **proper logs needed**. Appropriate accounting procedures are now being applied to control cash disbursements and cost allocations.

5. **Inadequate bookkeeping procedures:** **p. 22**

   EQI maintains bank registers for both LE and $ accounts. As of January 1993, bank reconciliations are prepared on a monthly basis. EQI is able to reconcile Bank register balances with the General Ledger. And since the observation was made that EQI reconciles its record with the bank statement, the statement made that some deposits are not recorded is invalid.

During 1991 and 1992, the double entry system of accounting and the accounting books and records were only kept for statutory and tax purposes and, therefore, transactions not affecting these records were disregarded. The auditors were informed that the books were prepared for tax department purposes only. EQI now has its own automated general ledger system which has detailed transactions, and which enables the extraction of data at all levels

- Finally, we are attaching a copy of the certification dated March 1, 1994, from KPMG Hazem Hassan, commenting on the design and implementation of our accounting system. See Attachment 12.

Appendix C

Auditor's Response

We received Environmental Quality International's (EQI) response to our draft audit report. EQI separated their response into four parts corresponding to our report on findings for the contract and overhead audits. In our response the page number refers to EQI's presentation document.

Contract Audit

Our draft report presented four findings. Our comments on EQI's response is as follows:

Finding 1 - Salaries (P. 1)

Our position is unchanged as EQI merely defined why the overbillings occurred.

Finding 2 - Office Support Services and Computers (P. 1)

We are not debating the rate. It is our opinion that the FAR requires consistency in costing methodology. Our finding remains in the report.

Finding 3 - Transportation (P. 1)

We interpret the FAR Section 31.109.h.2 as requiring an advance agreement prior to changing certain costs and we do not find such an agreement in the contract, therefore our finding remains as presented.

Finding 4 - Four Note Book PCs and Depreciation and Supplies (P. 2)

We still believe that a portion of the cost is reasonable, but continue to believe that 287,500 pages of documentation for this project is unreasonable.

Internal Control

We believe the implementation of the recommended internal control procedures will enhance EQI's accounting system. On page 6 of EQI's response under "Expense Classification" it is stated that the books are only kept for statutory and tax purposes, but we believe USAID regulations also require books/records to account for financial affairs related to USAID contracts.

Follow-up of Prior Audit Recommendations

We have no comment on the response.

Part II

Environmental Quality International
Audit of Indirect Cost and Fringe Benefits Rates
For The Years Ended December 31, 1992 and 1991

35 ~

Environmental Quality International
Audit of Indirect Cost and Fringe Benefits Rates
For the years ended December 31, 1992 and 1991

Audit Objectives, Scope and Methodology

The objective of this engagement is to conduct a financial audit of the indirect cost and fringe benefits rates of Environmental Quality International for the years ended December 31, 1992 and 1991. The specific objectives of this audit are to:

1. express an opinion on whether the direct and indirect cost, and fringe benefits schedules of Environmental Quality International present fairly, in all material respects, only allowable and allocable costs for the periods under audit in conformity with applicable cost principles;

2. determine that the direct cost allocation base includes only items and costs authorized by USAID and the applicable cost principles;

3. determine that the indirect cost pool includes costs authorized by USAID and applicable cost principles;

4. evaluate whether the indirect rate is accurately calculated and that the costs included in this calculation reconcile to total expenses shown in the financial statements;

5. evaluate and obtain a sufficient understanding of the internal control structure of the organization; assess control risk; and identify reportable conditions, including material internal control weaknesses.

The scope of our financial audit was all direct and indirect expenses incurred by Environmental Quality International for the years ended December 31, 1992 and 1991. The methodology of our audit consisted of an internal control evaluation, testing of direct and indirect expenses, and testing adherence by Environmental Quality International with applicable Federal Acquisition Regulations (FAR) cost principles and applicable laws and USAID regulations.

Because of the absence of internal control we relied on substantive testing in the performance of our audit. Our testing was directed toward reviewing expenses for each indirect cost line item and selectively testing direct costs. The total expenses and amounts tested by year are:

Per Financial Statements (Unadjusted)		Tested	% Tested
1992	$ 891,514	$ 345,127	39%
1991	$ 860,301	$ 459,935	53%

Our testing program included, but was not limited to the following major steps:

1. General ledgers and journals were reconciled to financial statements.

2. Reviewed direct and indirect costs to assure their proper allocation and classification.

3. Ascertained that labor allocation was based on time reported on time sheets.

4. Reviewed bank deposits to ensure that rebates, discounts and other credits were properly deducted from expenses.

5. Selectively reviewed billings to projects to ensure direct costs were in agreement with applicable contracts.

6. Indirect costs and fringe benefits schedules were reconciled to general ledger and journals.

7. Tested direct and indirect costs to assure that only allowable, allocable and reasonable costs are included in the cost pools.

We reviewed and evaluated the organization's internal control structure to obtain an understanding of the design of relevant control policies and procedures and whether these polices and procedures have been placed in operation. We obtained a sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing and extent of tests to be performed and we assessed risk.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the indirect costs and fringe benefits rate schedules are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 46 of Chapter 3 of Government Auditing Standards since no such quality review program is offered by professional organizations in Egypt.

We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

Management Comments:

Environmental Quality International responded to the findings in this report. Their comments are included in Appendix E beginning on page 69.

Our comments to their response are included in Appendix F beginning on page 78.

ALLIED ACCOUNTANTS
Ragheb, Sherif, Istanbouli & El Kilany
A Member Firm of ARTHUR ANDERSEN & Co. SC
Public Accountants &Business Advisors
Fellows & Members of the Egyptian Society of Accountants & Auditors

المحاسبون المتضامنون
راغب ، شريف ، اسطنبولي والكيلاني
مراسلو آرثر أندرسن وشركاه
محاسبون قانونيون وخبراء تنظيم وادارة
زملاء وأعضاء جمعية المحاسبين والمراجعين المصرية

Mr. Phillipe Darcy
Regional Inspector General for Audit/Cairo
United States Agency for
International Development
Cairo, Egypt

Dear Mr. Darcy:

Independent Auditor's Report

We have audited the indirect cost and fringe benefits rate schedules of Environmental Quality International for the years ending December 31, 1992 and 1991. These indirect cost and benefits rate schedules are the responsibility of Environmental Quality International's management. Our responsibility is to express an opinion on these schedules based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the indirect cost and fringe benefits schedules are free of material misstatement. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the indirect cost and fringe benefits rate schedules. Our audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall indirect cost and fringe benefits rate schedules presentation. We believe that our audit provides a reasonable basis for our opinion.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 46 of Chapter 3 of Government Auditing Standards since no such quality review program is offered by professional organizations in Egypt. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Arthur Andersen & Co. worldwide internal quality control program which requires our office to be subjected, every three years, to an extensive quality control review by partners and managers from other Arthur Andersen & Co. offices.

As described in Note 1, the accompanying indirect cost and fringe benefits rate schedules were prepared on the modified cash basis which is a comprehensive basis of accounting other than generally accepted accounting principles.

العنوان : ٣٧ شارع الأحرار ، برج موبيكا ، المهندسين - ص. ب. ٩٧ الدقي ، جيزة ، مصر تليفون : ٣٦٠٨١١١ فاكس : ٣٦٠٠٨١٣
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Included in the indirect cost rate schedules are questioned costs of $ 55,561 in indirect costs and $ 3,581 in direct costs for the year ended December 31, 1992 and $ 46,105 in indirect costs and $ 37,225 in direct costs for the year ended December 31, 1991. The bases for questioning costs are set forth in the indirect cost and fringe benefits rate schedules - Audit Findings Section of this report.

In our opinion, except for questioned costs of $ 55,561 in indirect costs and $ 3,581 in direct costs for the year ended December 31, 1992 and $ 46,105 in indirect costs and $ 37,225 in direct costs for the year ended December 31, 1991, the indirect cost and fringe benefits rate schedules referred to above present fairly, in all material respects, Environmental Quality International's indirect cost and fringe benefits rates for years ended December 31, 1992 and 1991, in accordance with the modified cash basis of accounting described in Note 1 to the indirect cost and fringe benefits rate schedules.

Our audit was made for the purpose of forming an opinion on the indirect cost and fringe benefits rate schedules included in the first paragraph. The supplemental information enclosed in Appendices (A) through (D) is presented for purposes of additional analysis and are not required as a part of the basic financial schedules. Such information has been subject to the auditing procedures applied in the audit of the indirect cost and fringe benefits rate schedules and, in our opinion, is fairly stated in all material respects in relation to the schedules taken as a whole.

This report is intended for the information of the management and others within Environmental Quality International and the US Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

December 20, 1993

Allied Accountants

Schedule 1

Environmental Quality International
Indirect Cost Schedule and Indirect Cost Rate Calculation
For the year ended December 31, 1992
(In US Dollars)

Expense Category	Adjusted Financial Statements	Questioned Costs Unallowable	Questioned Costs Unsupported	Net Balance	Findings
Rent	24,714		3,976	20,738	1
Telephone and fax	16,033	15		16,018	3
Miscellaneous	4,589	2,260		2,329	4
Bank charges	4,068	1,044		3,024	5
Cleaning	1,558	11	241	1,306	6
Electricity and gas	4,463			4,463	
Entertainment	2,868	2,868		0	7
Transportation	17,077	36		17,041	8
Stationery expenses	11,973			11,973	
Maintenance and repairs	1,957			1,957	
Consulting fees	3,167		1,054	2,113	10
Computer expenses	5,487		22	5,465	11
Audit fees	6,024			6,024	
Travel & per diem	34,283	22,033	920	11,330	13
Legal fees	90	90		0	15
Depreciation	37,092	5,372		31,720	16
Guest reception	1,288	1,288		0	17
Membership fees	904			904	
Salaries	122,968	13,316		109,652	18
Total indirect costs	300,603	48,333	6,213	246,057	
Fringe benefits	80,291	1,015		79,276	14
Total		$ 55,561			

Indirect cost rate calculation (Note 3):

$$\frac{\text{Indirect Expenses (Sch. 1)} \quad 246{,}057}{\text{Direct Salaries (Sch. 1-A)} \quad 340{,}886} = 72.18\%$$

See accompanying notes to the indirect and direct cost and fringe benefits schedules.

Schedule 1-A

Environmental Quality International
Direct Cost Schedule
For the year ended December 31, 1992
(In US Dollars)

Expense Category	Adjusted Financial Statements	Questioned Costs Unallowable	Questioned Costs Unsupported	Net Balance	Findings
Transportation	16,862			16,862	
Travel and per diem	56,098			56,098	
Computer	304			304	
Salaries and overtime	1,045			1,045	
Housing allowance	2,711			2,711	
Photocopying and stationery	4,056			4,056	
General expenses	48			48	
Trainers' fees	3,635			3,635	
Consulting fees	9,401			9,401	
Pictures/films	24,434			24,434	
Photocopy design	969			969	
Project site	602			602	
ICOF	2,486			2,486	
Morena guard	572			572	
Survey	301			301	
Guest reception	1,946	1,946		0	17
Training supplies	736			736	
Telephone and mail	760			760	
Depreciation	9,883			9,883	
Subtotal	136,849	1,946		134,903	
Salaries	340,886		1,635	339,251	18
Total	477,735	1,946	1,635	474,154	
		$ 3,581			

See accompanying notes to the indirect and direct cost and fringe benefits schedules.

Schedule 2

Environmental Quality International
Indirect Cost Schedule and Indirect Cost Rate Calculation
For the year ended December 31, 1991
(In US Dollars)

Expense Category	Adjusted Financial Statements	Questioned Costs Unallowable	Questioned Costs Unsupported	Net Balance	Findings
Rent	25,804		2,945	22,859	1
Telephone and fax	17,455	4,052		13,403	3
Miscellaneous	2,598	1,703		895	4
Bank charges	3,549			3,549	5
Cleaning	1,311		8	1,303	6
Electricity and gas	3,305			3,305	
Entertainment	3,202	3,202		0	7
Transportation	11,672	1,789	113	9,770	8
Stationery	10,822			10,822	
Maintenance and repairs	4,979			4,979	
Consulting fees	19,541		307	19,234	10
Computer	3,821		46	3,775	11
Audit fees	7,669			7,669	
Travel and per diem	15,111	8,393	307	6,411	13
Legal fees	8,152	5,510	2,642	0	15
Depreciation	20,689	7,042		13,647	16
Survey costs	1,179			1,179	
Salaries	92,582	2,454		90,128	18
Total indirect costs	253,441	34,145	6,368	212,928	
Fringe benefits	74,486	5,592		68,894	2
		$ 46,105			

Indirect cost rate calculation (Note 3):

$$\frac{\text{Indirect Expenses (Sch. 2) } 212{,}928}{\text{Direct Salaries (Sch. 2-A) } 339{,}678} = 62.68\%$$

See accompanying notes to the indirect and direct cost and fringe benefits schedules.

Schedule 2-A

Environmental Quality International
Direct Cost Schedule
For the year ended December 31, 1991
(In US Dollars)

Expense Category	Adjusted Financial Statements	Questioned Costs Unallowable	Questioned Costs Unsupported	Net Balance	Findings
Filming	20,906			20,906	
Car and transportation	9,215			9,215	
Electric supplies	297			297	
Travel and per diem	65,283			65,283	
Entertainment	352	352		0	7
General expenses	1,194			1,194	
Photocopying and Stationery	4,046			4,046	
Computer supplies	526			526	
Rent	4,296		1,472	2,824	1
Electricity	77			77	
Maintenance and repairs	249		63	186	9
Cleaning	10			10	
Housing allowance	8,282			8,282	
Project appraisal	717			717	
Consulting fees	18,611		18,427	184	10
Construction fees	16,017			16,017	
Toys project	20,854			20,854	
Telephone,telex and fax	344			344	
Depreciation	8,184			8,184	
Subtotal	179,460	352	19,962	159,146	
Salaries	339,678	2,920	13,991	322,767	18
Total	519,138	3,272	33,953	481,913	
		$ 37,225			

See accompanying notes to the indirect and direct cost and fringe benefits schedules.

Schedule 3

Environmental Quality International
Fringe Benefits Schedule and Fringe Benefits Rate Calculation
For the year ended December 31, 1992
(In US Dollars)

Expense Category	Net Balance
Vacation	22,079
Sick leave	4,742
Holiday	17,720
Paid vacation	1,355
Housing allowance	2,997
Subtotal	48,893
EQI's social insurance share	25,074
Medical allowance	353
Labor day allowance	248
Travel allowance	3,951
English course	757
Total	79,276

Fringe benefits rate calculation:

$$\frac{\text{Indirect fringe benefits}}{\text{Total salaries}} = \frac{79{,}276}{463{,}854} = 17.09\%$$

Salaries :

Indirect	- Schedule 1	$ 122,968
Direct	- Schedule 1-A	340,886
		463,854

See accompanying notes to the indirect and direct cost and fringe benefits schedules.

Schedule 4

Environmental Quality International
Fringe Benefits Schedule and Fringe Benefits Rate Calculation
For the year ended December 31, 1991
(In US Dollars)

Expense Category	Net Balance
Vacation	19,369
Sick leave	4,408
Holiday	20,684
Housing allowance	1,380
Subtotal	45,841
EQI's social insurance share	18,828
Medical allowance	212
Travel allowance	4,013
Total	68,894

Fringe benefits rate calculation:

$$\frac{\text{Total fringe benefits } 68{,}894}{\text{Total salaries } 432{,}260} = 15.94\%$$

Salaries :

Indirect	- Schedule 2	$ 92,582
Direct	- Schedule 2-A	339,678
		432,260

See accompanying notes to the indirect and direct cost and fringe benefits schedules.

Environmental Quality International
Notes to the Indirect and Direct Cost and Fringe Benefits Schedules

Note 1 : Basis of Presentation

The indirect cost and fringe benefits schedules have been prepared on the modified cash basis which includes cash receipts and disbursements plus depreciation. Consequently, receipts and expenditures are recognized when received or paid rather than when earned or incurred.

Note 2 : Adjusted Financial Statements

The direct and indirect, and fringe benefits schedules prepared by Environmental Quality International did not reconcile with the financial statements. Appendices A through B-1 presents the financial statements and amounts reclassified, adjusted and excluded to arrive at the adjusted financial statement amounts presented on schedules 1, 1-A, 2, 2-A, 3, and 4. Reclassifications, adjustments and excluded are defined as follows:

1. Reclassifications - EQI made a substantial number of reclassification entries between direct and indirect expenses. None of these reclassification entries were recorded in the revenue and expense books and, therefore, were not included in the financial statement amounts. The reclassification entries were made to correct misclassifications between expense categories and between the direct/indirect cost pools. Some of the EQI reclassifications were improperly made or unsupported whereas other entries reclassified expenses from direct project costs to include expenses because project costs were not budgeted for, costs exceeded the project budget or the financing entity disallowed the cost. Also, included as reclassifications are costs related primarily to salaries and fringe benefits that we indentified during our audit.

   The reclassifications shown in appendices A through B-1 are reclassifications that we determined are correct and supported and are required to present a realistic financial statement.

2. Adjustments - Entries under adjustments represent unrecorded cash expenses noted during the audit.

3. Excluded - Amounts categorized as excluded are costs identified by EQI as unallowable and the portion of management's expenses considered by EQI to be personal.

Note 3 : Indirect Cost and Fringe Benefits Basis

The base for the indirect cost rate calculation is total direct salaries. The indirect cost rate was calculated by dividing the net indirect cost pool (net of questioned cost) by the total direct salaries as required by Federal Acquisition Regulations, Part 31, Section 31-203, C.

Fringe benefits include vacation, sick leave, holidays, housing allowance, EQI's share of social security, travel allowance and other allowances granted to employees under EQI policies. The fringe benefits rate has been calculated by dividing the net allowable fringe benefits by the total adjusted direct and indirect salaries not excluding questioned amounts. According to Federal Acquisition Regulations, Part 31, Section 31-203 (C) unallowable direct costs should bear a pro rata share of indirect cost.

Note 4 : Exchange Rate

Expenses incurred in local currency (LE) have been converted into US$ at an average exchange rate of LE 3.32/US $ for 1992 and LE 3.26/US $ for 1991.

Note 5 : Questioned Cost

Incurred questioned costs are presented in two categories: unallowable and unsupported costs. Questioned costs are those expenses we have determined not to be in accordance with the applicable cost principles and other applicable USAID regulations or because they are not supported with adequate documentation. "Unallowable costs" are deemed to be unallowable because they are prohibited by the applicable cost principles or USAID regulations/policies. These costs are supported by adequate documentation. "Unsupported costs" are expenses which are not supported by adequate documentation or were not authorized/approved by the proper officials.

The basis or reason for questioning specific costs are set forth in the "Audit Findings Sections" of this report.

Environmental Quality International
Overhead Audit

Audit Findings Section

Finding 1 - Rent

Condition:

During fiscal years 1992 and 1991 EQI paid rent expense in the amount of LE 13,200 and 14,400, respectively, for the Architectural Department office. There is no contract for the rent of this office.

	1992	1991
Direct Cost - Unsupported		LE 4,800
		$ 1,472
Indirect Cost - Unsupported	LE 13,200	LE 9,600
	$ 3,976	$ 2,945

Criteria:

It is a general practice and required by law in Egypt to have a contract for facilities rental. Also, USAID regulations require costs to be documented.

Cause:

According to the Finance Director no contract was signed for rental of this office because the landlord refused to sign the agreement. Effective in 1993 a contract was signed for this office.

Effect:

Unsupported cost in the amount of $ 3,976 was recorded as indirect cost in 1992 and, $ 1,472 as direct cost and $ 2,945 as indirect cost in 1991.

Finding 2 - Social Security

Condition:

EQI's share of social security recorded in the financial statements for fiscal year 1991 was overstated by LE 18,230 ($ 5,592).

Criteria:

According to the Federal Acquisition Regulations, Part 31 - Section 201-5, Credits, a credit or refund of any allowable cost received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.

Cause:

During 1991, EQI paid social security for employees seconded to another consulting firm. The other firm reimbursed EQI for the social insurance cost, however, EQI did not apply the payment to reduce social insurance cost. EQI does not reconcile its social insurance account with its payments and receipts, therefore, the reimbursement was not properly credited.

Effect:

The cost of social insurance is overstated by $ 5,592 for 1991.

Finding 3 - Telephone and Fax

Condition :

Unallowable costs for telephone deposits and penalties were recorded in indirect expenses as follows:

		1992	1991
Penalties:			
1/31/91	Cash	LE	LE 50
7/30/91	Cash		50
7/10/91	397510		8
2/19/92	Ch # 427372	50	
Deposits:			
1/13/91	Ch # 390350		8,800
9/30/91	Ch # 416290		4,300
		50	13,208
		$ 15	$ 4,052

Criteria:

Fines and penalties are unallowable per Federal Acquisition Regulations, Part 31, Section 205-15. Payments to the Telephone Authority for "telephone insurance" are deposits to guarantee payment. These payments should be recorded as an asset rather than expended.

Cause:

EQI was not aware that penalties are unallowable. Because the deposits/telephone insurance are refundable by the Telephone Authority only if the service is terminated, EQI considers these amounts to be expendable instead of recording them as an asset.

Effect:

Questioned expenses in the amount of $ 15 and $ 4,052 were recorded as indirect expenses for fiscal years 1992 and 1991, respectively.

Finding 4 - Miscellaneous

Condition:

Miscellaneous expenses include unallowable expenses as follows:

		1992		1991
Tips	LE	1,459	LE	1,861
Flowers		1,944		1,412
Gratuities		2,940		1,879
Donations		158		400
New year celebrations		203		
Medical fees		400		
Pictures		400		
		7,504		5,552
	$	2,260	$	1,703

Criteria:

According to Federal Acquisition Regulations, Part 31, Section 205-14 and 205-8 these expenses are unallowable.

Cause:

EQI was unaware of the FAR provision.

Effect:

Unallowable costs in the amount of $ 2,260 and $ 1,703 for fiscal years 1992 and 1991, respectively, were recorded as indirect costs.

Finding 5 - Bank Charges

Condition:

In January 1992, a debit from the bank to pay a promissory note installment for a photocopy machine was recorded as bank charges.

January 1992 - Bank debit	LE 3,465
	$ 1,044

Criteria:

This payment was an installment payment that should be recorded as debt reduction.

Cause:

The accountant in charge of recording bank charges did not notice that this charge was an installment payment and recorded it as bank charges.

Effect:

Unallowable expense in the amount of $ 1,044 was recorded as indirect expenses.

Finding 6 - Cleaning Expenses

Condition:

In our testing of cleaning expenses we noted unsupported and ineligible expenses for food/drinks.

			1992	1991
Unsupported				
June/91	Cash		LE	LE 25
July/92	Ch # 285293		800	
			800	25
			$ 241	$ 8
Ineligible				
Sept/92	Cash		LE 38	
			$ 11	

Criteria:

EQI should keep adequate documentation to support all disbursements as required by prudent business practices.

Cause:

Lack of adherence to EQI's internal procedures and the lack of review by the Finance Department supervisors permitted payment without supporting documentation.

Effect:

Unsupported expenses in the amount of $ 241 and $ 8 for fiscal years 1992 and 1991, respectively, and $ 11 in questioned expenses for fiscal year 1992 were recorded as indirect costs.

Finding 7 - Entertainment

Condition:

Payments for receptions, lunches, theater tickets and other social activities were recorded under entertainment during 1992 and 1991. We question total entertainment costs as follows:

	1992	1991
Indirect cost	LE 9,523	LE 10,440
	$ 2,868	$ 3,202
Direct cost		LE 1,148
		$ 352

Criteria:

Entertainment costs are unallowable per Federal Acquisition Regulations, Part 31, Section 205-14.

Cause:

EQI was not familiar with the FAR provision.

Effect:

Questioned expenses were booked under the indirect cost pool in the amount of $ 2,868 in fiscal year 1992 and $ 3,202 under indirect cost and $ 352 under direct cost for fiscal year 1991.

Finding 8 - Transportation

Condition:

During 1992 and 1991 EQI paid repairs and maintenance for rented vehicles. We are questioning the repairs of the rented car because there was no contract, the owner of the car received a daily payment for his services and no repairs should be paid for this rented car. In addition, the amount paid for repairs seems unreasonably high. Our test disclosed related payments which are unsupported or questioned as follows:

		1992	1991
Unsupported			
3/9/91	Cash		LE 325
12/12/91	Ch # 730540		32
6/11/91	Cash		11
			368
			$ 113

		1992	1991
Unallowable			
3/13/91	Ch # 399545 Penalties	LE	LE 94
4/23/91	Ch # 397494 Repairs		1,000
4/23/91	Ch # 405985 Repairs/ Personal expenses		2,504
6/13/91	Ch # 403258 Repairs		1,000
6/20/91	Ch # 403286 Repairs		500
6/30/91	Ch # 403180 Repairs		469
3/20/91	Ch # 399559 Repairs		265
9/15/92	Cash Penalties	20	
11/19/92	Ch # 1297562 Tips	100	
		120	5,832
		$ 36	$ 1,789

Criteria:

According to the Federal Acquisition Regulations, the allowability of an expense should be based on reasonableness and allocability. The lack of supporting documentation impairs our determination of whether this expense is allowable.

Effect:

Included in the indirect cost pool were $ 36 of unallowable expenses for year 1992 and $ 1,789 and $ 113 of unallowable and unsupported expenses, respectively, for year 1991.

Finding 9 - Maintenance and Repairs

Condition:

During our testing, we detected payments for maintenance and repairs charged to direct costs that are without supporting documentation.

	1991
8/19/91 Ch # 406851	LE 207
	======
	$ 63
	======

Criteria:

According to the Federal Acquisition Regulations, the allowability of an expense should be based on reasonableness and allocability. The lack of supporting documentation impairs our determination of whether this expense is allowable.

Cause:

Project officers do not approve expenses billed to their projects and the Finance Department did not require documentation to support the payment as mandated by prudent business practices.

Effect:

Unsupported expenses in the amount of $ 63 were recorded under direct project expenses.

Finding 10 - Consulting Fees

Condition:

Our tests disclosed payments for consulting fees without a contract or other supporting documentation as follows:

	1992	1991
Indirect Costs:		
12/19/91 Ch # 423818		LE 1,000
7/27/92 Ch # 276744	LE 3500	
	3500	1,000
	=======	========
	$ 1,054	$ 307
	=======	========

		1992	1991
Direct Costs:			
12/10/91	Ch # 730539		LE 5,850
5/7/91	Ch # 403324		10,200
5/16/91	Ch # 405407		8,375
5/8/91	Ch # 403320		8,901
5/15/91	Ch # 403338		1,214
7/7/91	Ch # 405415		25,531
			60,071
			$ 18,427

Criteria:

Payment of consulting fees should be supported by a contract, which should define the consultant's duties and responsibilities and amount/method of payment. Therefore, payment should be based on the contract and should be supported by either approved time sheets or invoices.

Cause:

According to the Finance Director, some consultants refuse to have contracts for tax reasons. Other payments were approved by EQI's President without adequate supporting documentation.

Effect:

Unsupported expenses were booked as direct costs and indirect costs in the amount of $ 18,427 and $ 307, respectively, for 1991 and booked as indirect cost in the amount of $ 1,054 for 1992.

Finding 11 - Computer Expenses

Condition:

Unsupported computer expenses which were noted during our testing are as follows:

		1992	1991
9/3/91	Cash		LE 150
9/30/92	Ch # 754184	LE 72	
		72	150
		$ 22	$ 46

Criteria:

According to the Federal Acquisition Regulations, the allowability of an expense should be based on reasonableness and allocability. The lack of supporting documentation impairs our determination of whether this expense is allowable.

Cause:

Lack of adequate supervision and adherence to internal policies led to payment without documentation.

Effect:

Unsupported expenses were recorded as indirect costs in the amount of $22 and $123 during fiscal years 1992 and 1991, respectively.

Finding 12 - Audit Fees

We examined additional supporting documentation provided by EQI and consider it adequate to verify the cost incurred. The finding has been removed from the report.

Finding 13 - Travel and Per Diem

Condition:

During our test of travel and per diem expenses, we noted payments for airline tickets and per diem that either were not adequately supported or EQI could not provide relevant documentation to support the allowability of the expense as part of the indirect cost pool.

	Date	Check #	Amount 1992	Amount 1991
Unsupported indirect costs:				
	6/30/91	Cash		LE 1,000
	7/21/92	405456	LE 3,054	
Total unsupported costs			3,054	1,000
			========	=====
			$ 920	307
			========	=====
Unallowable indirect costs:				
Bonuses	3/10/91	399541	LE	LE 2,388
	12/9/91	423811		546
Business development	12/5/91	730513/		8,438
	12/5/91	730514/		
	12/12/91	730544/		
	12/24/91	423838		
	3/25/91	683396		3,320

	Date	Check #	Amount 1992	Amount 1991
Business development	5/15/91	405404		1,075
	8/7/91	405405		3,350
	9/1/91	405419		3,330
	3/15/91	399564		4,315
	1/29/92	405441	6,012	
	5/6/92	405452	5,934	
	5/18/92	405454	20,444	
	7/30/92	285205	10,000	
	8/30/92	285325	10,000	
	9/15/92	291582	10,000	
	10/11/92	297486	8,958	
First class ticket	1/13/92	423943	1,800	
Total unallowable indirect costs			73,148	27,362
			$ 22,033	8,393

Criteria:

Bonuses
Bonuses, according to Federal Acquisition Regulations, Part 31, Section 205-6, are only allowable if they are paid under an agreement entered into in good faith between employer and the employees before the services are rendered, or pursuant to an established employer's policy.

Business development
Expenses recorded under travel and per diem as business development do not meet the criteria per Federal Acquisition Regulations, Part 31, Section 205-36, 6 (d).

Cause:

EQI considered these expenses as "Business Development".

Effect:

Unallowable expenses in the amount of $ 22,033, and $ 8,393, were recorded as indirect costs in 1992 and 1991, respectively, and unsupported costs were recorded as indirect expenses in the amount of $ 920, and $ 307 for fiscal years 1992 and 1991, respectively.

Finding 14 - Medical Allowance

Condition:

In 1992, EQI paid the health insurance premium for EQI's President in the amount of LE 3,370 ($ 1,015)

Criteria:

According to Federal Acquisition Regulations, Part 31 - Section 31-205-6-M, fringe benefits are allowable to the extent that they are reasonable, required by law, an employer-employee agreement or an established policy of the employer. This payment does not meet such criteria.

Cause:

EQI considered the payment of the health insurance as a fringe benefit.

Effect:

Unallowable expenses were booked as indirect costs in the amount of $ 1,015 for fiscal year 1992.

Finding 15 - Legal Fees

Condition:

During years 1992 and 1991 EQI paid legal fees in the amount of LE 18,263 related to the incorporation of a company in which it is holding an equity interest. Also, during year 1991 unsupported payments in the amounts of LE 8,612 were made.

		1992	1991
Unsupported:			
Legal Consultant			LE 8,612
			$ 2,642
Unallowable:			
07/8/91	Ch # 397502	LE	LE 2,000
07/30/91	Ch # 406818		4,500
12/24/91	Ch # 405434		11,463
02/18/92	Ch # 427371	300	
		300	17,963
		$ 90	$ 5,510

Criteria:

We are questioning the legal fees because they are not related to the normal business operations of EQI. They should be recorded as investments or receivables. Payment of legal fees should be supported with a contract or engagement letter and an invoice.

Cause:

EQI's President approved the payments.

Effect:

Unallowable expenses were recorded as indirect costs in the amount of $ 90 and $ 5,510 for fiscal years 1992 and 1991 and unsupported cost in the amount of $ 2,642 was booked as indirect expenses in 1991.

Finding 16 - Depreciation

Condition:

Depreciation expenses were understated by LE 77 in 1992 and overstated by LE 6,296 in 1991.

Also, during 1991 and 1992 EQI acquired pictures which are being depreciated and included in indirect expenses as follows:

	1992	1991
Unallowable:		
Overstated (Understated)	LE (77)	LE 6,296
Depreciation on pictures @ 25% of acquisition cost	17,913	16,662
	17,836	22,958
	$ 5,372	$ 7,042

We are questioning the above depreciation because, in our opinion, it is not necessary for the normal operation of the business and the cost is unreasonable.

Criteria:

Subsidiary records should support the calculation of depreciation and the calculation should be reviewed and approved by the Finance Director.

According to Federal Acquisition Regulations, Part 31, Section 201-4 an expense is allocable if it is necessary for the overall operation of the business.

Cause:

The calculation of depreciation is not reviewed by the Finance Director. According to EQI's Finance Director and Finance Advisor the pictures are necessary for the enhancement of EQI's offices.

Effect:

Unallowable depreciation expenses were recorded as indirect costs in the amount of $ 5,372 and $ 7,042 for fiscal years 1992 and 1991, respectively.

Finding 17 - Guest Reception

Condition:

Payments for guest receptions such as luncheons, dinners and other social activities were incurred in 1992 and recorded as indirect and direct costs as follows:

	1992
Direct	LE 6,461
	$ 1,946
Indirect	4,277
	$ 1,288

We question all payments for guest receptions as being unallowable.

Criteria:

Entertainment costs are unallowable per Federal Acquisition Regulations, Part 31, Section 31-205-14.

Cause:

EQI was not familiar with the FAR Regulations

Effect:

Unallowable expenses in the amounts of $ 1,946 as direct costs and $ 1,288 as indirect costs were recorded in 1992.

Finding 18 - Salaries

Condition:

For the salaries tested during 1992 and 1991, we noted payments without supporting documents or no contracts, and unreasonable salary increases as follows:

	Date	Check #	Amount 1992	Amount 1991
Indirect salaries unsupported:				
Bonuses	3/10/91	399542	LE	LE 2,500
Bonuses	3/31/91	397444		2,000
Bonuses	12/19/91	423808		3,500
Unsupported and unreasonable salary/ Editor			34,994	
Unsupported and unreasonable salary/Editor			9,215	
Total unallowable indirect salaries			44,209	8,000
			$ 13,316	$ 2,454
Direct salaries unallowable:				
No contract and unreasonable salary	5/17/91 6/13/91	403323/ 403276	LE	LE 9,520
Total direct salaries unallowable			-0-	9,520
			$ -0-	$ 2,920
Direct salaries-unsupported/no contract	2/28/91	683391/		31,548
	2/28/91	399535		
	5/27/91	403348		3,677
	7/30/91	406814		1,000
	2/28/91	399510		369
	2/6/91	397671		861
	3/19/91	399551		1,290
	4/9/91	397474		675
	4/14/91	397483		1,280
	7/25/91	397518		970
	12/19/91	423803		1,320
	12/19/91	423804		360
	5/6/91	403313		1,040
	6/13/91	403265		1,220

	Date	Check #	Amount 1992	Amount 1991
Direct salaries-unsupported/no contract	3/10/92	431079	590	
	3/15/92	431084	2,999	
	7/30/92	285273	880	
	10/25/92	754238	960	
Total direct salaries-unsupported			5,429	45,610
			$ 1,635	$ 13,991

Criteria:

Bonuses, according to the Federal Acquisition Regulations, Part 31, Section 205-6, are only allowable if they are paid under an agreement entered into in good faith between employer and the employees before the services are rendered or pursuant to an established employer's policy.

According to the Federal Acquisition Regulations, Part 31, Section 205-6, compensation must be based upon an established compensation plan or practice followed consistently, and payments must be reasonable for the work performed.

Cause:

EQI does not have well defined policies regarding compensation. They do not follow specific criteria in classifying when the employee should be hired as a full-time or a part-time employee.

Effect:

Unsupported salary payments in the amounts of $ 1,635 and $ 13,991 were charged to direct costs in 1992 and 1991, respectively. Expenses considered to be unreasonable/unallowable, in the amount of $ 13,316, were charged to indirect cost in 1992 and $ 2,920 was charged to direct cost in 1991. Also, unallowable bonus payments in the amount of $ 2,454 were charged to indirect cost in 1991.

Finding 19 - Dahab Project

We originally included the finding in our report because there are direct salaries which do affect the overhead calculation and we wanted to disclose that fact. We agree that other aspects of cost do not affect the overhead calculation and we have removed the finding from our report.

APPENDICES

Appendix A

Environmental Quality International
Schedule of Indirect Costs
For the year ended December 31, 1992

Presented in Egyptian Pounds (LE) and in US ($) Dollars

Expense Category	Balance Per Financial Statements (LE)	Reclassifications Debit (LE)	Reclassifications Credit (LE)	Adjustments (LE)	Excluded (LE)	Adjusted Financial Statements (LE)	Adjusted Financial Statements (US$)	Questioned Costs (LE)	Questioned Costs (US$)	Net Balance (LE)	Net Balance (US$)
Rent	82,050					82,050	24,714	13,200	3,976	68,850	20,738
Telephone and fax	64,384	212	909		10,458	53,229	16,033	50	15	53,179	16,018
Miscellaneous	20,999	1,459	5,396		1,825	15,237	4,589	7,504	2,260	7,733	2,329
Bank charges	99,882				86,375	13,507	4,068	3,465	1,044	10,042	3,024
Cleaning	5,697	50	574			5,173	1,558	838	252	4,335	1,306
Electricity and gas	14,818					14,818	4,463			14,818	4,463
Entertainment	12,774	951	4,202			9,523	2,868	9,523	2,868	0	0
Transportation	65,263	1,613	3,985		6,196	56,695	17,077	120	36	56,575	17,041
Stationery	41,525	9,287	10,440	100	720	39,752	11,973			39,752	11,973
Maintenance and repairs	15,332		8,835			6,497	1,957			6,497	1,957
Consulting fees	27,385		16,161		709	10,515	3,167	3,500	1,054	7,015	2,113
Computer	19,599	122	1,505			18,216	5,487	72	22	18,144	5,465
Audit fees	20,000					20,000	6,024			20,000	6,024
Travel & per diem	228,203	70	64,160		50,293	113,820	34,283	76,202	22,953	37,618	11,330
Legal fees	300					300	90	300	90	0	0
Depreciation	155,955		32,810			123,145	37,092	17,836	5,372	105,309	31,720
Guest reception		4,277				4,277	1,288	4,277	1,288	0	0
Membership fees		3,000				3,000	904			3,000	904
Salaries	1,435,569	223,169	1,296,538	46,053		408,253	122,968	44,209	13,316	364,044	109,652
Total indirect costs	2,309,735	244,210	1,445,515	46,153	156,576	998,007	300,603	181,096	54,546	816,911	246,057
Vacation, sick leave, etc.		162,326				162,326	48,893			162,326	48,893
Social security	82,290			955		83,245	25,074			83,245	25,074
Medical allowance	3,370	1,173				4,543	1,368	3,370	1,015	1,173	353
Travel allowance		13,117				13,117	3,951			13,117	3,951
Labor day allowance		825				825	248			825	248
English course		2,512				2,512	757			2,512	757
Total fringe benefits	85,660	179,953	0	955	0	266,568	80,291	3,370	1,015	263,198	79,276

Environmental Quality International
Schedule of Direct Cost
For the year ended December 31, 1992

Presented in Egyptian Pounds (LE) and US ($) Dollars

Expense Category	Balance Per Financial Statements (LE)	Reclassifications Debit (LE)	Reclassifications Credit (LE)	Adjustments (LE)	Excluded (LE)	Adjusted Financial Statements (LE)	Adjusted Financial Statements (US$)	Questioned Costs (LE)	Questioned Costs (US$)	Net Balance (LE)	Net Balance (US$)
Car and transportation	50,704	6,292	1,015			55,981	16,862			55,981	16,862
Travel and per diem	141,875	56,465	12,096			186,244	56,098			186,244	56,098
Computer		1,008				1,008	304			1,008	304
Salaries and overtime	211,910		208,440			3,470	1,045			3,470	1,045
Housing allowance	9,000					9,000	2,711			9,000	2,711
Photocopying and stationery	4,524	9,282	339			13,467	4,056			13,476	4,056
General	2,996		2,838			158	48			158	48
Hosting	3,446		3,446			0	0			0	0
Trainers' fees	14,244	10,667	12,844			12,067	3,635			12,067	3,635
Consulting fees	29,268	1,944				31,212	9,401			31,212	9,401
Pictures/films	79,474	1,353		293		81,120	24,434			81,120	24,434
Photocopy designs	3,218					3,218	969			3,218	969
Project site	2,000					2,000	602			2,000	602
ICOP	8,253					8,253	2,486			8,253	2,486
Morena guard	1,900					1,900	572			1,900	572
Survey		1,000				1,000	301			1,000	301
Guest receptions		6,461				6,461	1,946	6,461	1,946	0	0
Training supplies		2,445				2,445	736			2,445	736
Telephone and mail	1,621	901				2,522	760			2,522	760
Depreciation		32,810				32,810	9,883			32,810	9,883
Subtotal	564,433	130,628	241,018	293	0	454,336	136,849	6,461	1,946	447,875	134,903
Salaries		1,131,742				1,131,742	340,886	5,429	1,635	1,126,313	339,251
Total direct costs	564,433	1,262,370	241,018	293	0	1,586,078	477,735	11,890	3,581	1,601,188	474,154
Total Costs (App. A & A-1)	2,959,828	1,686,533	1,686,533	47,401	156,576	2,850,653	858,629	196,356	59,142	2,681,297	799,487

Appendix B

Environmental Quality International
Schedule of Indirect Cost
For the year ended December 31, 1991

Presented in Egyptian Pounds(LE) and US ($) Dollars

Expense Category	Balance Per Financial Statements (LE)	Reclassifications Debit (LE)	Reclassifications Credit (LE)	Adjustments (LE)	Excluded (LE)	Adjusted Financial Statements (LE)	Adjusted Financial Statements (US$)	Questioned Costs (LE)	Questioned Costs (US$)	Net Balance (LE)	Net Balance (US$)
Rent	94,024		9,904			84,120	25,804	9,600	2,945	74,520	22,859
Telephone and fax	67,669		1,120	50	9,698	56,901	17,455	13,208	4,052	43,693	13,403
Miscellaneous	11,664	833	4,027			8,470	2,598	5,552	1,703	2,918	895
Bank charges	42,812			17,123	48,364	11,571	3,549			11,571	3,549
Cleaning	4,250	4	36	53		4,271	1,311	25	8	4,246	1,303
Electricity and gas	11,019		244			10,775	3,305			10,775	3,305
Entertainment	9,845	735	298	158		10,440	3,202	10,440	3,202	0	0
Transportation	85,799	3,861	50,104	(117)	1,388	38,051	11,672	6,200	1,902	31,851	9,770
Stationery	51,285	3,021	19,027			35,279	10,822			35,279	10,822
Maintenance and repairs	5,743	10,694	205			16,232	4,979			16,232	4,979
Consulting fees	125,725	1,400	63,420			63,705	19,541	1,000	307	62,705	19,234
Computer	10,128	3,000	670			12,458	3,821	150	46	12,308	3,775
Audit fees	25,000					25,000	7,669			25,000	7,669
Travel and per diem	128,815		78,590	970	1,932	49,263	15,111	28,362	8,700	20,901	6,411
Legal fees	17,963	8,612				26,575	8,152	26,575	8,152	0	0
Depreciation	94,126		26,681			67,445	20,689	22,958	7,042	44,487	13,647
Survey costs		3,845				3,845	1,179			3,845	1,179
Salaries	1,509,322	71,206	1,278,712			301,816	92,582	8,000	2,454	293,816	90,128
Subtotal indirect costs	2,295,189	107,211	1,533,038	18,237	61,382	826,217	253,441	132,070	40,513	694,147	212,928
Vacation, sick leave, etc.		149,443				149,443	45,841			149,443	45,841
Social security	79,610					79,610	24,420	18,230	5,592	61,380	18,828
Medical allowance		691				691	212			691	212
Travel allowance		13,083				13,083	4,013			13,083	4,013
Total fringe benefits	79,610	163,217	0	0	0	242,827	74,486	18,230	5,592	224,597	68,894

Environmental Quality International
Schedule of Direct Cost
For the year ended December 31, 1991

Presented in Egyptian Pounds (LE) US ($) Dollars

Expense Category	Balance Per Financial Statements (LE)	Reclassifications Debit (LE)	Reclassifications Credit (LE)	Adjustments (LE)	Excluded (LE)	Adjusted Financial Statements (LE)	Adjusted Financial Statements (US$)	Questioned Costs (LE)	Questioned Costs (US$)	Net Balance (LE)	Net Balance (US$)
Filming	66,670	1,482				68,152	20,906			68,152	20,906
Car and transportation	31,462	11,170	12,591			30,041	9,215			30,041	9,215
Electric supplies	56	962	49			969	297			969	297
Travel and per diem	145,932	66,892				212,824	65,283			212,824	65,283
Entertainment	1,561	297	710			1,148	352	1,148	352	0	0
General	1,066	2,913	85			3,894	1,194			3,894	1,194
Overtime	7,613		7,613			0	0			0	0
Photocopying and Stationery	6,073	8,795	1,677			13,191	4,046			13,191	4,046
Computer supplies	1,630	85				1,715	526			1,715	526
Rent	3,600	10,404				14,004	4,296	4,800	1,472	9,204	2,824
Electricity	8	244				252	77			252	77
Maintenance and repairs	1,739	34	962			811	249	207	63	604	186
Cleaning	11	20				31	10			31	10
Housing allowance	27,000					27,000	8,282			27,000	8,282
Project appraisal	5,648	690	4,000			2,338	717			2,338	717
Consulting fees	10,715	49,956				60,671	18,611	60,071	18,427	600	184
Construction fees	51,015	1,700	500			52,215	16,017			52,215	16,017
Toys project	67,983					67,983	20,854			67,983	20,854
Telephone, telex and fax		1,120				1,120	344			1,120	344
Depreciation		26,681				26,681	8,184			26,681	8,184
Subtotal	429,782	183,445	28,187	0	0	585,040	179,460	66,226	20,314	518,814	159,146
Salaries		1,115,352	8,000			1,107,352	339,678	55,130	16,911	1,052,222	322,767
Total Direct Costs	429,782	1,298,797	36,187	0	0	1,692,392	519,138	121,356	37,225	1,571,036	481,913
Total Costs (App. B & B-1)	2,804,581	1,569,225	1,569,225	18,237	61,382	2,761,436	847,065	271,656	83,330	2,489,780	763,735

Appendix C

Environmental Quality International
Schedule of Fringe Benefits
For the year ended December 31, 1992
Presented in Egyptian Pounds (LE) and US ($) Dollars

Expense Category	Net Balance	
	(LE)	(US$)
Vacation	73,303	22,079
Sick leave	15,743	4,742
Holiday	58,832	17,720
Paid vacation	4,498	1,355
Housing allowance	9,950	2,997
Subtotal	162,326	48,893
EQI's social insurance share	83,245	25,074
Medical allowance	1,173	353
Labor day allowance	825	248
Travel allowance	13,117	3,951
English course	2,512	757
Total fringe benefits	263,198	79,276

Appendix D

Environmental Quality International
Schedule of Fringe Benefits
For the year ended December 31, 1991
Presented in Egyptian Pounds (LE) and US ($) Dollars

Expense Category	Net Balance	
	(LE)	(US$)
Vacation	63,144	19,369
Sick leave	14,368	4,408
Holiday	67,431	20,684
Housing allowance	4,500	1,380
Subtotal	149,443	45,841
EQI's social insurance share	61,380	18,828
Medical allowance	691	212
Travel allowance	13,083	4,013
Total fringe benefits	224,597	68,894

AUDITEE'S RESPONSE TO DRAFT NFA REPORT

ENVIRONMENTAL QUALITY INTERNATIONAL
3B BAHGAT ALI STREET, ZAMALEK, CAIRO, EGYPT.
TEL: 3400052 - 3408284 FAX: 3413331 TELEX: 23172 NAOOM UN

April 1994

ENVIRONMENTAL
QUALITY
INTERNATIONAL

April 7, 1994

Mr. Eugene E. Smith
Allied Accountants
37 El Ahrar Street
Mohandessine, Cairo

Dear Mr. Smith,

Attached please find EQI's response to the audit of Indirect Cost and Fringe Benefit Rates for the Field Verification and Monitoring of Human Resources and Development Cooperation Project, USAID/Egypt Contract No. 263-0000-C-00-2203-00, covering the years ended December 31, 1991 and 1992.

Yours sincerely,

Ahmed Bahgat
Project Manager

cc: Mr. Syed Ali - FM/AM
Mr. Jim Garen - RIG/A
Mr. Mr. Duncan Miller - AD/HRDC
Mr. Leonel Pizarro - DIR/CS

3B, Bahgat Ali Street, Zamalek, Cairo, Egypt Tel: 3408284 - 3400052 Tlx: 23172 NAOOM UN Fax: 3413331

OVERHEAD AUDIT

AUDIT FINDINGS SECTION

Finding 1: Rent p. 38

The landlord refused to sign a contract because EQI is an Egyptian firm and by law Egyptians can take over a flat after proving residence for 3 years. However, checks were issued in the name of the landlord against a receipt for payment for each specific month to cover the period in question. Cost is documented (Attachment 3). After dealing with EQI for a few years, however, the landlord felt comfortable enough to sign a contract in 1993. The expense should therefore, be allowed.

Finding 2: Social Security p. 38

Agreed.

Finding 3: Telephone and Fax p. 39

Checks # 285285 and 285298, dated 7/30/92 and 8/6/92 for LE 4,270 and LE 430, respectively, were paid to cover expenses for installation of a new telephone/fax line (Attachment 4). These expenses do not include any deposits retained by the Telecommunication Authority, and are, therefore, not refundable. Hence, they should be allowed. Checks # 390350 and 416290, for LE 8800 and LE 4300, respectively, were paid as deposits to the Telecommunications Authority to cover delinquency in payment, should this occur. Deposits are refundable from the Authority only if the service is terminated. Accordingly, these amounts will remain with the Telephone Authority until such time as the contract is terminated. Once refund is received from the Authority, it will be credited to USAID.

Finding 4: Miscellaneous p. 40

Except for medical fees, which should have been classified under Fringe Benefits, miscellaneous expenses include costs that are necessary for business operations, public relations and business development, such as tips, flowers, donations and gratuities, porter's wage, garage, mail, etc... These costs are mandatory and cannot possibly be avoided.

Moreover, we would like to document a miscalculation on the part of the auditors. The amount of LE 5,552 of questioned miscellaneous costs for the year ending December 31, 1991 was deducted from the "Adjusted Financial Statements" and not from the "Balance per Financial Statements", as it should have been. The "Net Balance" column under "Miscellaneous Items" should, therefore, read LE 6112 and not LE 2918 as it stands in the auditor's report.

Finding 5: Bank Charges p. 41

Agreed.

Finding 6: Cleaning Expenses p. 41

Agreed.

Finding 7: Entertainment p. 42

Receptions and lunches are necessary for acquiring new clients and opening new business opportunities. These costs are documented and incurred by management-level personnel. The reclassification of the General Ledger account should be made to read "Business Development Expenses" instead of "Entertainment".

Finding 8: Transportation p. 43

Agreed.

Finding 9: Maintenance and Repairs p. 44

The LE 207 represents cost of labor undertaken by the electrician. Electricians in Egypt do not issue invoices.

Finding 10: Consulting Fees p. 44

Indirect Costs:
Check # 423818, dated 12/19/91, for LE 1,000 represents an expense incurred in connection with preparation of the urban poverty proposal, and was paid to obtain necessary information. It was considered to be business development and was classified under the Indirect Cost pool since the job was not awarded. Check # 276744 was paid to the Company's legal advisor to cover her legal consultation charges. Unfortunately, the necessary supporting documents are not available, because many egyptian professionals refuse to supply them. Even though this may deviate from standard accounting principals, we sometimes feel obliged to be accommodating in situations involving expenses that do not relate to a USAID assignment.

Direct Costs:
In general, all direct costs, amounting to $ 18,427, under finding # 10 are neither charged to the HRDC project nor do they effect the overhead calculation. Accordingly, they should not be presented in the auditor's report.

Finding 11: Computer Expenses p. 45

Check # 403310 dated 5/5/91 amounting to LE 250 is the cost of renting a laser printer. The invoice is included (Attachment 5).

Finding 12: Audit Fees p.46

All three checks were issued in the name of Yousria Loza, who is a partner at the Safwat Labib office. The letter of engagement is available, according to which audit fees are to be determined annually based upon actual work performed (Attachment 6). Financial statements for the years 1991 - 1992 are available.

Finding 13: Travel and Per Diem p. 47

Checks # 730513/730514/730544/423838, respectively, are covered by an invoice amounting to LE 8,438. The participation of EQI as a local anchor for the megacities project required that a series of meetings be held in Cairo with their nucleus team and that the cost of those meetings be shared. Without these meetings, EQI could not have been an accredited anchor for the project, nor could it have received funding for subsequent engagement in megacities project activities. The time cost and out-of-pocket expenses stated above represent the cost of business development activities necessary prior to the conclusion of a contractual arrangement. They are tantamount to the cost of preparation of a proposal. The travel cost of the nucleus team was borne by the NY office, on condition that the local accommodation cost be borne by EQI. See Attachment 7.

Checks # 405454/285205/285325/291582/297486 cover the cost of Mr. Neamatalla and Mr. Tolba of EQI who travelled to Brazil on a business trip to attend the United Nation's conference on Environment and Development (UNCED) in 1992. The business trip was essential to permit EQI to receive the UNCED Honors Certificate Award for the Zabbaleen Environmental Project, alongside Cairo Governorate. It also allowed EQI to contribute to, and benefit from, this important world forum on environment and development. The side trip to Sao Paulo was necessary because EQI had to make presentations in the Global Trade and Technology Fair about the Zabbaleen project being honored. It also allowed EQI to acquaint itself with state-of-the-art technology in environmental management, the company's central business activity. This is, therefore, a reasonable and legitimate business development expense and should be regarded as an overhead cost. See Attachment 8.

Check # 423943 for a first class ticket should not be completely disallowed. Costs of economy class should be considered instead. See Attachment 9.

Checks # 405494/405495 were paid by EQI for one of its staff members to attend a training course sponsored by USAID. EQI incurred all expenses. See Attachment 10.

We would like to point out that the reference to the Federal Acquisition Regulations, made by the auditor, is incorrect. It should read Section 31.205-1-F-1.

Finding 14: Medical Allowance p. 48

The expense is reasonable, and the President is the only member of the firm to travel extensively. This insurance covers him internationally. We do not have an international blanket coverage for EQI as a whole, since employees seldom travel.

We would like to point out that the reference to Federal Acquisition Regulations, provided by the auditor, deals with **Deferred Compensation**, and not with medical allowance. Instead, the auditor should have referred to FAR Section 31.205-6-m, which deals with **Fringe Benefits**.

Finding 15: Legal Fees p. 49

Agreed

Finding 16: Depreciation p. 49

The prints hanging on the walls of EQI premises consist entirely of marine life, flora and fauna, and wild life, as well as selected artisanal and architectural themes related to Egypt's cultural heritage. They represent the corporate culture of the firm and illustrate its principal field of business. They also contribute to the enhancement of the working environment of the staff, representing an important source of inspiration. These prints are recorded as a company asset and are acknowledged by the Egyptian Tax Authorities as such. The annual contested depreciation expense of this asset is at LE 17.91 per square meter, representing 5 % of the cost rental and operation of EQI premises and facilities. This is a clear demonstration of the reasonableness and wisdom of this investment.

Finding 17: Guest Reception p. 50

Payments for guest receptions is an essential part of business activities in Egypt, which rely to a great extend on personal contacts and public relations.

Finding 18: Salaries p. 51

Indirect Salaries:
Checks # 399542/397444/423808 cover extra compensation for work performed. See Attachment 11. The sum of LE 44,209.43, represents salary payments of LE 34,994.04 and LE 9,215.39 to two editors. The auditor has excluded these amounts, claiming them to be questionable, unreasonable, and unsupported. These payments are supported by staff time sheets. If the auditor feels that the total amounts are unreasonable, he should still determine a "reasonable" portion to be retained in the indirect cost pool, since the work was performed and payments were made to the two individuals in question based on EQI's evaluation of their services.

Direct Salaries:

Checks for direct salaries have supporting documentation. In any case, since direct salaries do not affect the overhead pool or the HRDC project, they are outside the scope of this audit. We, therefore, request that the auditor strike out this section (Direct Salaries) from the report.

Salary-Related Information for 1992/1991: (Found in Appendices A-1 and B-1, respectively)

Fluctuations Between Number of Working Days and Actual Daily Rate:

EQI bills its clients on an average of 21.67 working days/month, or 173.36 hours per month, according to USAID contract regulations. When the number of working days per month is under 21.67, the actual daily rate is altered. To ensure that the daily rate remains consistent with the monthly payroll, any fluctuation in number of days must be recorded and classified as fringe benefits. These fluctuations between the daily rate and the monthly payroll resulted in a difference of LE 14,757.16 in 1992 and of LE 19,727.37 in 1991. These amounts should be classified under fringe benefits or indirect cost, being unworked time for which employees are paid. Since it is unbilled time, the auditor's classification of these amounts as direct costs is unjustified. The auditor should, therefore, exclude these amounts from the direct salary calculation and include them under fringe benefits.

Schedule of Direct Cost for 1991:

According to EQI's salary distribution, the amount of LE 78,916 was classified under "Other Payments". The auditor classified LE 74,972.36 of the above amount as a Direct Cost. This should be reduced as follows: Salary payments made to editors - Sawsan El Zayyat, LE 4,035.32 and Mona Khan, LE 2,461.71 - and salary payments made to accountant - Ekbal Hassaan, LE 456.52 - should be classified as indirect costs, totalling LE 6,953.55. The remaining amount of LE 68,018.81, representing various amounts paid to short-term employees prior to their changing to a full-time status, should be analyzed and allocated to either direct or indirect costs based on an analysis of their time sheets.

Under the direct labor distribution schedule analyzed by the auditor for 1991, LE 7,682.67, classified as "Differences", was added to the direct salaries. It must be pointed out that a portion of the above amount was already included in the LE 19,727.37 classified by the auditor under direct salaries.

Schedule of Direct Cost for 1992:

The auditor's analysis of direct salaries at LE 1,131,742 includes LE 10,399.05, which represents direct consulting fees on projects for Abdel Wahab Amer, Abdel Sadek Bazaraa, and Mohsen Sherif, who are outside consultants on short-term assignments. Their consulting time cost should be considered as direct project expenses and should not be included in direct salaries.

Moreover, the LE 1,131,742 includes LE 13,160.70, which represents direct consulting fees for architects assigned to work on projects on an hourly or lump-sum basis. Their consulting time cost should also be considered as a direct project expense and not be included in direct salaries.

Finally, in the calculation of direct salaries, the auditor includes LE 199,609.41 and LE 46,053.47. These amounts represent actual direct project expenses - spent on employees assigned to work for a limited period of time under temporary, short-term assignments - and their cost should not be included in direct salaries. The LDII personnel have already concluded their assignment and are no longer with the firm.

Finding 19: Dahab Project p. 53

All costs incurred for the Dahab Project have been classified as pre-operating expenses. Moreover, all Dahab-related costs have also been classified as direct expenses. This project is, therefore, outside the auditor's scope of work. Costs incurred neither effect the overhead calculation nor the HRDC project.

Cost of Company Management:

Despite several discussions with the auditor concerning the above-mentioned issue, the audit report failed to acknowledge the necessity of accounting for the cost of services rendered by Mounir Soliman Neamatalla in providing the necessary leadership and day-to-day management of the firm, ascribing a zero-value to it.

Under Egyptian law, a partner does not command a salary. In the past, EQI used to charge a General & Administrative (G&A) rate of 8% to cover the indirect cost of the active partner's time input in the firm. This allowed EQI to comply with the law and at the same time fully recover the indirect cost of company management. Previous USAID-commissioned audit reports have, without exception, recommended that this be changed, and that a level of compensation be assessed and applied to the costing of partner time. This was further corroborated by a detailed overhead analysis undertaken by KPMG Hazem Hassan in 1992, covering the period 1988 - 1990. The auditor produced an assessed rate after studying the partner's salary history prior to 1980, and adjusting it for the audit period 1988-1990. KPMG Hazem Hassan further recommended that EQI treat this cost as a component of its overhead charges, instead of applying the fixed G&A of 8%. Since then, we have adhered to the auditor's recommendation and calculated partner's compensation accordingly. A final settlement was reached between EQI and the US Government according to the above-mentioned principle.[1] See Attachment 11. It appears that as a result of the present Arthur Andersen's audit, EQI should now undo all the recommendations of the previous audits and reinstate its old practice of charging a fixed General and Administrative rate to comply with the current audit report and recover its management costs.

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[1] The Regional Inspector General for Audit (RIG/A), Audit Report # 6-263-93-01-N, dated October 5, 1992.

CONCLUSION

In order to assess the reasonableness of the indirect charges recommended by Arthur Anderson in their report and their impact on the financial performance of the company during the period 1991 - 1992 EQI has conducted the following financial analysis. (Tables 1 and 2)

By applying the recommended rates for 1991, the revenues of the firm drop from LE 2,924,437 to LE 2,496,614 while the expenses remain unchanged and the attendant net loss will be LE 307,967.

As for 1992, the revenues drop from LE 3,194,357 to LE 2,703,258 while the expenses remain unchanged and the attendant net loss will be LE 256,572.

The indirect charges of the firm have to be a minimum of 129.26% to reach breakeven for 1991 and a minimum of 99.7% to reach breakeven for 1992. This analysis confirms that applying the overhead rate determined by the auditors is not realistic or reasonable because it would certainly impair the financial viability of the company.

In other words, EQI would not be able to recover its cost on any or all of its cost plus fixed fee contracts with USAID. Furthermore, our Financial Analysis shows that the provisional O.H. rate is applied on USAID contracts for the years 1991, 1992 and 1993 tally with the computed indirect charges necessary to reach breakeven.

This demonstrates the reasonableness of our costing computations and should serve as a guideline for determining realistic indirect rates to be applied over the periods 1991, 1992 and 1993.

Auditor's Response

We received Environmental Quality International's (EQI) response to our draft audit report. EQI separated their response into four parts corresponding to our report on findings for the contract and overhead audits. In our response the page number refers to EQI's presentation document.

Overhead Audit

Finding 1 - Rent (P. 9)

USAID requires costs to be documented - this cost was not. Our finding remains unchanged.

Finding 2 - Social Security (P. 9)

The audit report is unchanged.

Finding 3 - Telephone and Fax (P. 9)

EQI has provided additional documentation to support their position that LE 4,270 and 430 are installation charges. We have changed our report to reflect the change, however, the remainder of the finding remains as originally presented.

Finding 4 - Miscellaneous (P. 9)

EQI reclassified certain amounts from miscellaneous to other accounts, but LE 5,552 remained in miscellaneous and was presented as questioned costs to properly exclude it from the indirect cost pool. It is not a miscalculation.

Finding 5 - Bank Charges (P. 9)

The audit report is unchanged.

Finding 6 - Cleaning Expense (P. 10)

The audit report is unchanged.

Finding 7 - Entertainment (P. 10)

Under either classification these costs are not allowable according to the FAR. Our finding remains in the report.

Finding 8 - Transportation (P. 10)

The audit report is unchanged.

Finding 9 - Maintenance and Repairs (P. 10)

Without supporting documentation the cost is not allowable and our finding is unchanged.

Finding 10 - Consulting Fees (P. 10)

We were unable to locate documentation for the LE 1,000 or LE 3,500 checks, consequently we questioned the cost and leave the finding in the report.

We agree the US $ 18, 427 in indirect costs do not affect the overhead rate.

Finding 11 - Computer Expense (P. 10)

We accept the documentation provided and have removed the LE 250 in questioned cost.

Finding 12 - Audit Fees (P. 11)

We examined additional supporting documentation provided by EQI and consider it adequate to verify the cost incurred. The finding has been removed from the report.

Finding 13 - Travel and Per Diem

According to EQI's response the LE 8, 438 is a business development costs. The FAR allows certain types of business development costs, but we interpret the regulations as not including the type of costs incurred by EQI. We are not convinced that this expense is allowable under FAR 31.205-43 and we leave this finding in the report.

The LE 1, 800 paid for a first class ticket is unallowable and we are not responsible for determining what other options may be allowable. The finding remains in the report.

The business development costs associated with Dr. Neamatallah and Mr. Tolba representing the Governor of Cairo it the ICLEI Conference does not meet the requirements of FAR 31.205-43 as we interpret the regulation. They were representing the Cairo Governor and did not appear to be attending the conference in connection with an on-going contract. Furthermore, we find it unreasonable that EQI would incur costs of LE 59,402 to represent the Cairo Governor without some form of quid pro quo. The finding remains in the report.

The LE 21, 645 of training cost incurred to send an EQI employee to the US for training appears to be adequately documented even though no reason was provided as to why the six government officials from the AOYE had their expenses paid by USAID and the EQI employees' costs were not paid. However, we have removed the finding and adjusted the overhead rate calculation.

Finding 14 - Medical Allowances (P. 12)

We see no company policy determination, as required by the FAR, referred to in EQI's response. The finding remains in the report.

Finding 15 - Legal Fees (P. 12)

The audit report is unchanged.

Finding 16 - Depreciation (P. 12)

We remain unconvinced that the prints in question are reasonable and necessary for EQI's business operation. The finding remains as presented.

Finding 17 - Guest Receptions (P. 12)

We understand that such receptions are a normal cost of doing business in Egypt as well as most business cultures of the world. However, FAR 31.205-14 defines such costs as unallowable. The finding remains as presented.

Finding 18 - Salaries (P. 12)

Indirect Salaries

The payments of LE 2,500, 2,000 and 3,500 represent bonus payments which we believe do not meet the FAR criteria for allowability. EQI did not have a policy addressing bonuses and we found no agreement/ contract which supports these payments. Our audit report remains unchanged.

For the year 1989, an individual worked full time as an editor for EQI and was paid LE 1,200 per month (LE 55/day). She quit at the end of 1989 and started back to work in 1992 for EQI on a part time basis at a salary of US $ 183 day (LE 610), however, there was no contract supporting her employment. Even if the inflation rate were 30% for the intervening two years, we still see the salary increase as unreasonable. The finding associated with the LE 34, 994 remains in the report.

A second editor worked two months full time at a salary of LE 1,800 per month. She then began working part time (with no contract) and she worked the same number of hours as a full time employee, but her salary was increased from LE 1,800 to LE 2,900. We see the 60% salary increase as unreasonable and have retained the finding in our report.

Direct Salaries

For direct salaries in the amount of LE 45,610 we were provided no documentation in EQI's response. Contrary to EQI's assertion that direct salaries do not affect overhead rates, we respond by pointing out that direct salaries form the base through which indirect costs are allocated. The LE 45,610 of questioned direct cost remains in our report.

Fluctuations

EQI was inconsistent in allocating variances arising through the use of 21.67 days to distribute time worked. We found numerous instances where EQI allocated the cost to direct time as well as indirect time or fringe benefits. We conclude that if time were properly allocated, at year end the variance for each employee should be zero. EQI provided no analysis in their response for us to review, therefore, the finding remains in the report.

Schedule of Direct Cost for 1991

EQI was asked to reallocate salaries for 1991 and 1992 after we finished our initial audit testing of salaries. The reason we requested the reallocation is that EQI's initial salary allocations did not match the time reported on time sheets. Our salary test error rate was above 50%.

EQI reallocated salaries and we tested their reallocation. We tested LE 17, 461 out of the LE 78, 916. The results of our test indicate that 95 percent was direct salaries, 2 percent indirect salaries and 3 percent fringe benefits. The LE 78, 916 was allocated based on the results of our test. Included in our test was one of the editors who distributed her time as direct on her time sheet.

Our classification of the LE 7, 683 in "Differences" was properly handled. Per our workpapers the portion referred to by EQI was excluded properly.

Based on our analysis of EQI's response, we found no basis for changing our finding and, consequently, it remains in our report.

Schedule of Direct Cost for 1992

We classified the LE 10, 399 as salaries because EQI reallocated the cost to salaries and we agree with EQI's classification. EQI provided no documentation which would cause us to reevaluate the finding. The finding remains in our report.

The classification of LE 13, 161 as salaries was made by EQI. EQI provided no documentation supporting their change of mind, therefore, the finding remains in the report.

The salaries of LE 245, 662 were for an average of thirteen employees working for 5 months on the CIDA project and 2 months on the LD II project. EQI classified them as employees. Therefore, as direct salaries is the basis for allocating overhead, in our opinion these salaries are properly allocated. The finding remains in our report.

Finding 19 - Dahab Project (P. 14)

We included the finding in our report because there are direct salaries which do affect the overhead calculation and we wanted to disclose that fact. We agree that other aspects of cost do not affect the overhead calculation and we have removed the finding from our report.

Cost of Company Management (P. 14)

During our audit, we noted that in years prior to 1991 a salary was calculated for the company President and no reference was made as to whether the salary was actually paid or not. In our audit for years 1991 and 1992 we noted small payments to the President which were not classified as salary, likewise, when we asked if the President was paid a salary we were told that he was not.

EQI has confirmed that under Egyptian law, like the US law, a Partner's salary for the year is an amount which is determined by the company's profits. Therefore, in this case we believe we are prevented from arbitrarily arriving at a salary to be included as overhead cost by FAR 31.206.b (2) and by Egyptian law. We have not changed our position on this matter.

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

USAID

CAIRO EGYPT

June 19, 1994

M E M O R A N D U M

TO: Timothy E. Cox, A/RIG/A/C

FROM: Amanda Levenson, OD/FM/FA AHevenson

SUBJECT: Environmental Quality International (EQI) Audit of Field Verification and Monitoring of Human Resources and Development Cooperation Project Inputs under USAID/Egypt Contract No. 263-0000-C-00-2203-00 and the Audit of Indirect cost and Fringe Benefits Rates for the Years Ended December 31, 1991 and 1992 - Draft Report

Mission is working with the Contractor to resolve and close all the recommendations under the subject audit, and has no comments to offer at this time. Please issue the final report.

-82-

6/20/94

APPENDIX H

REPORT DISTRIBUTION

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