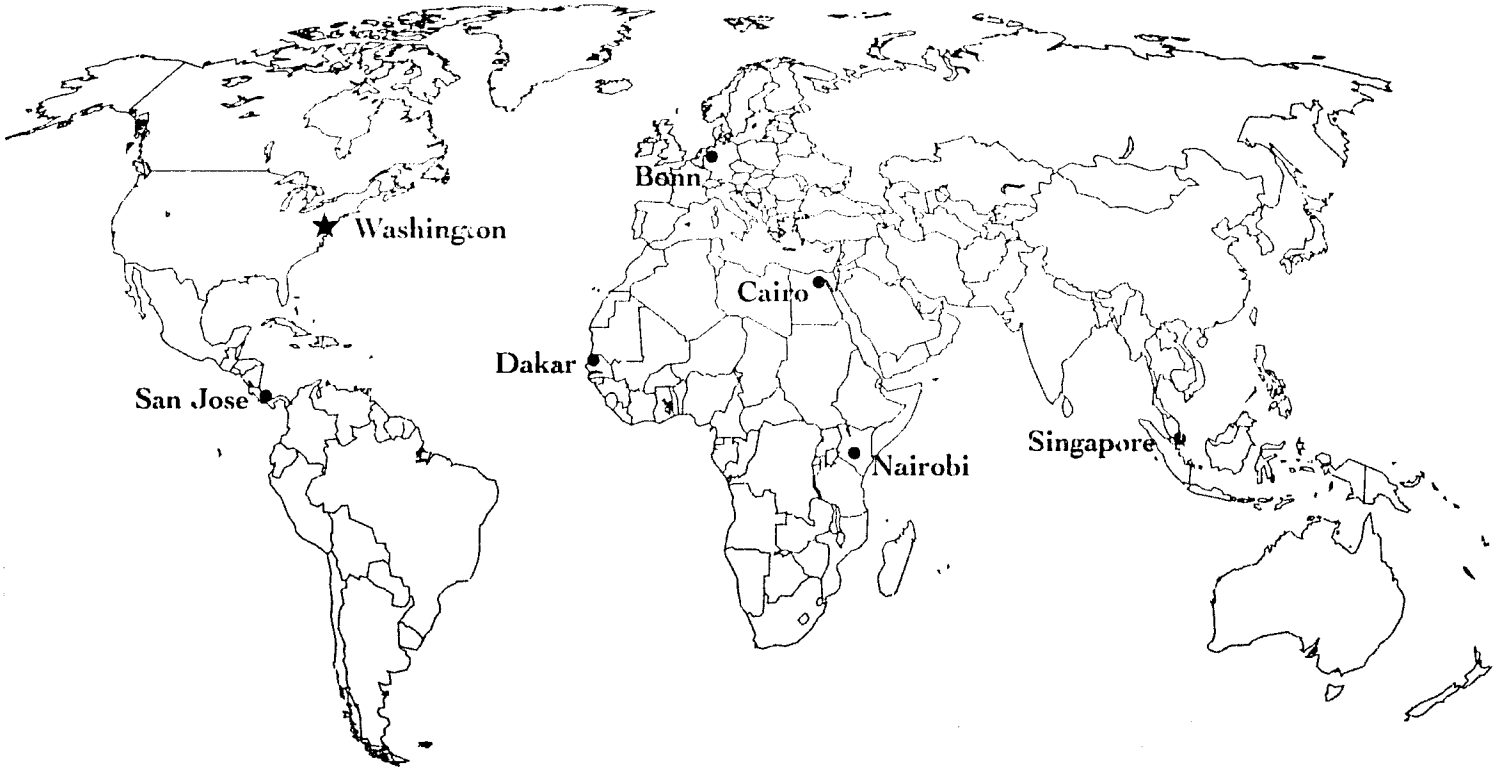
Regional Inspector General for Audit
Cairo, Egypt

Audit of the National Bank for Development, Local Expenditures Incurred Under the Small Enterprise Credit Project, Grant No. 263-0228

Report No. 6-263-96-001-N
October 1, 1995



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INSPECTOR GENERAL
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID

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

CAIRO, EGYPT

October 1, 1995

MEMORANDUM

TO : DIRECTOR USAID/Egypt, John R. Westley

FROM : RIG/A/C, Lou Mundy

SUBJECT: Audit of the National Bank for Development, Local Expenditures Incurred Under the Small Enterprise Credit Project, Grant No. 263-0228

The attached report transmitted on August 10, 1995, by Allied Accountants presents the results of a financial audit of the National Bank for Development (NBD), Local Expenditures Incurred Under the Small Enterprise Credit Project, Grant No. 263-0228. The objective of the Small Enterprise Credit Project is to provide loans to small businesses located throughout the Greater Cairo Metropolitan Area. The Agreement also provides funds for initial start-up costs, operating expenses, vehicles, equipment, and furniture to establish the NBD branch offices.

We engaged Allied Accountants to perform a financial audit of NBD's incurred expenditures of $3,470,013 (equivalent to LE11,659,245) as of October 31, 1994. The purpose of the audit was to evaluate the propriety of costs incurred during this period. Allied Accountants also evaluated NBD's internal controls and compliance with applicable laws, regulations and grant terms as necessary in forming an opinion regarding the Fund Accountability Statement.

Allied Accountants questioned $1,023,040 (equivalent to LE3,437,422) in costs billed to USAID by NBD. The questioned costs related primarily to salaries, vehicles, office equipment and furniture, training, and other direct costs. Additionally, they noted one reportable condition in NBD's internal controls and two instances of material noncompliance.

In response to the draft report, NBD gave more explanation to the questioned costs and took action, or started adopting procedures, to resolve the compliance issues. Allied Accountants reviewed NBD's response to the findings. Where applicable, they made adjustments to the report or provided further clarification of their position.

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

> **Recommendation No. 1: We recommend that USAID/Egypt resolve questioned costs of $1,023,040 consisting of ineligible costs of $693,110 and unsupported costs of $329,930 detailed on pages 15 through 18 of the audit report and recover from the National Bank for Development the amounts determined to be unallowable.**
>
> **Recommendation No. 2: We recommend that USAID/Egypt require the National Bank for Development to address the two material noncompliance issues (expenses incorrectly reported as "salaries" and the determination of when operational expense funding should have ceased) detailed on pages 24 and 25 of the audit report.**

In discussing the report's findings, the Mission emphasized that all of the expenditures audited were paid for out of host country-owned local currency. Therefore certain compliance requirements such as buying U.S. commodities would not necessarily apply. The Mission therefore contends in its comments (see Appendix C) on Recommendation No. 1 that questioned costs of $33,956 (including taxes) for the purchase of a Japanese vehicle should be removed. In addition, the Mission asked that questioned costs of $49,859 relating to the allocation of Headquarter's costs to the project be reduced to $17,659, based on an alternative allocation method. And finally, USAID/Egypt asked that Recommendation No. 2 be resolved based on its memorandum to the National Bank for Development asking the Bank to address the noncompliance issues cited in the report.

The Mission, in arranging to have an audit done on host country-owned local currency according to U.S. government auditing standards, has gone beyond what would be strictly required for audits of such currency. Nevertheless, we believe that even though U.S. source and origin requirements might not normally apply to host country-owned currency, the grant in this case clearly specifies that the project vehicle should be of U.S. source and origin (the grant, apparently had been drafted when direct U.S. funding was anticipated). Therefore--pending a more definitive legal opinion than the one attached to the comments--we believe that the more restrictive terms of the grant should govern and, thus, have not removed these questioned costs from the total requiring resolution.

As for the proposed alternative method for allocating Headquarter's costs to the project, we discussed this method with the auditors, who conceded that the alternative method might be "reasonable," although they had reservations about the basis for such allocation. They also noted, however, that there was no method specified in the grant to indicate just how such costs were to be allocated.

We therefore have not changed Recommendation No. 1, but suggest that the Mission contracting officer make a final determination on the allowability/allocability of these costs based on additional legal input and on a review of support for the proposed allocation method.

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Recommendation No. 1 is unresolved and will be considered resolved upon the Mission's determination of the amount of recovery; it will be considered closed upon the recovery of funds, offset of funds, or issuance of a bill for collection. Recommendation No. 2 is considered resolved and can be closed when the Mission presents evidence that appropriate actions have been taken.

The reportable condition identified by the auditor's review of the NBD's internal control structure should be handled directly between Mission and NBD officials.

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

National Bank for Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Financial Statements and
Fund Accountability Statements
For the Period From August 16, 1992 to
October 31, 1994

National Bank For Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Financial and Fund Accountability Statements

For the Period From August 16, 1992 to
October 31, 1994

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

Dear Mr. Darcy:

This report presents the results of the financial incurred cost audit of the Small Enterprise Loan Fund Agreement funded by the United States Agency for International Development Mission in Egypt (USAID/Egypt) pursuant to the Small Enterprise Credit Project Grant Agreement No. 263-0228 (SECP Grant). We were engaged to perform an audit of the operating expenditures incurred from August 16, 1992 to October 31, 1994 and a review of the loan portfolio pertaining to the Small Enterprise Loan Fund Agreement.

Background

Grant Agreement No. 263-0228 between the Arab Republic of Egypt and the United States of America for the Small Enterprise Credit Project (SECP) was signed on September 26, 1991; the Agreement remains in effect until September 30, 1995.

The Small Enterprise Loan Fund Agreement (SELFA) was signed between the National Bank for Development (NBD) and USAID/Egypt on August 16, 1992 to furnish funds to operate and capitalize the Small Enterprise Loan Fund pursuant to the SECP Grant Agreement; the Grant remains in effect until September 30, 1995.

The purpose of the SELFA is to provide loans to small enterprises located throughout the Greater Cairo Metropolitan Area. The Agreement also provides funds for initial start up costs, operating expenses, vehicles, equipment and furniture related to administration of the SELFA.

Audit Objectives, Scope, and Methodology

The objective of this engagement was to conduct a financial audit of USAID/Egypt resources managed by NBD pursuant to the Small Enterprise Loan Fund Agreement related to the Small Enterprise Credit Project (the "Project"). The specific objectives of our engagement were to:

1. Express an opinion on whether the fund accountability statements for the USAID/Egypt financed project of the SELFA present fairly, in all material respects, funds received and costs incurred for both , the loan and operating expense funds, for the audit period in conformity with generally accepted accounting principles or other comprehensive basis of accounting, including the cash basis and or modifications of the cash basis;

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2. Determine if the costs reported as incurred under the SELFA are in fact allowable, allocable, and reasonable in accordance with the terms of the Agreement;

3. Evaluate and obtain a sufficient understanding of the internal control structure of NBD as it relates to the SELFA, assess control risk, and identify reportable conditions, including material internal control weaknesses; and

4. Perform tests to determine whether NBD complied, in all material respects, with Agreement terms and applicable laws and regulations.

The scope of the financial cost-incurred audit was the loan fund and operating expenditures provided by USAID/Egypt for the period from August 16, 1992 to October 31, 1994.

The methodology of the audit consisted of an internal control evaluation, testing of loans and expenditures remitted under the financing agreement, and testing of compliance by NBD with specific provisions/requirements of the Agreement and applicable laws and regulations.

Our testing included a statistical selection of loans and a judgmental selection of costs incurred for each line item as disclosed in the financial and fund accountability statements. We tested costs as follows:

Line Item	Total Cost	Tested Amount	Percent
Loans disbursed during audit period	LE 75,708,195	LE 2,495,120	3%
(Equivalent in US$)	$ 22,532,201	$ 742,595	
Outstanding loans as 10/31/94	LE 22,806,243	LE 679,676	3%
(Equivalent in US$)	$ 6,787,572	$ 202,285	
Outstanding savings as 10/31/94	LE 3,186,983	LE 76,776	2%
(Equivalent in US $)	$ 948,507	$ 22,850	
Interest on savings for the audit period	LE 185,203	LE 76,858	41%
(Equivalent in US$)	$ 55,120	$ 22,874	
Operating expenses	LE 9,939,788	LE 7,878,237	79%
(Equivalent in US$)	$ 2,958,269	$ 2,344,713	
Fixed assets	LE 2,878,967	LE 2,022,455	70%
(Equivalent in US$)	$ 856,835	$ 601,921	

Because of the conditions identified in finding No. 1 to the fund accountability statements, we extended the scope of our testing to 100% of the expenses reported to USAID/Egypt under the "salaries" line item . Also, the percentage tested under "Fixed Assets" was significant primarily due to disbursements being concentrated in three large transactions related to the procurement of vehicles, computer equipment, and furniture for the head office and the thirteen branches.

Our testing program encompassed, but was not limited to the following procedures:

1. A review of direct project expenditures billed to and reimbursed by USAID/Egypt. General ledgers and cash journals were reconciled to billings submitted to USAID/Egypt.

2. A review of the funds provided by USAID/Egypt to ensure that they were deposited in separate bank accounts, and that the related transactions were properly recorded. We also performed a review of the procedures used to control cash at the head office and branch levels.

3. A review of training costs to determine if they are adequately documented and approved.

4. A review of procurement procedures to determine that sound commercial practices, including competitive bids, were used.

5. A determination of whether advances of funds were justified based on existing documentation, including a reconciliation of funds advanced, disbursed and available.

6. The statistical selection and review of 362 loans managed by the 13 branches implementing the project to determine eligibility of borrower, proper calculation of interest and other loan charges, compliance with SELFA policies, and repayment of loan.

7. The 362 selected borrowers were visited by different members of our audit team to determine existence of borrower, confirmation of loan disbursement, outstanding balance and use of loan.

8. A review of the accounting and related reporting of the loan revenue, use of the insurance fee collected from borrowers, collection of saving deposits from borrowers as required by SELFA, and interest paid on the saving deposits.

We reviewed and evaluated NBD's internal control structure as it relates to the SELFA to obtain an understanding of the design of relevant control policies and procedures, and whether those 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.

The agreement terms and pertinent laws and regulations applicable to the SELFA were reviewed and audit procedures were designed to test for noncompliance.

Initial planning began with an entrance conference attended by our audit team, RIG/A/C personnel, NBD management staff and the USAID/Egypt Project officer. The Grant Agreement, SELFA and related project implementation letters were reviewed to gain an understanding of the Agreement terms and cost principles.

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 statements are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 33 of Chapter 3 of Government Auditing Standards (1994 revision) 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 Statements

Our audit identified $ 1,023,040 (LE 3,437,422) in aggregate questioned costs. The details of costs questioned are presented in the Financial and Fund accountability Statements - Findings Section of this report.

Internal Control

Our evaluation of the internal control structure identified deficiencies in cash management at the operating branch level. We assess these deficiencies relating to cash management as being a reportable condition in the system of internal control. The detail of the reportable condition is presented in the Internal Control Structure - Audit Findings Section of this report.

Compliance with Applicable Laws and Regulations

In performing our engagement, we identified matters of material noncompliance. These matters relate to **i)** expenses reported under the "Salaries " line item consisting of bonuses to NBD Senior Officers, administrative costs paid to NBD (the Bank), and contingency costs and, **ii)** a determination to be made by the United States Agency for International Development in Egypt regarding the appropriate period to cease funding NBD's operating expenses relating to the Project. Details related to these noncompliances are set forth in the Compliance - Audit Findings Section of this report.

Management Comments

Management has provided comments on the results of the audit findings. The entire response of management is included in Appendix A. We provided responses to management's comments in Appendix B. We have deleted or modified findings relating to questioned costs and internal control matters that were adequately responded to by NBD management.

Allied Accountants - Cairo, Egypt

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

Report of Independent Public Accountants

We have audited the accompanying statements of assets, liabilities and project fund as of October 31, 1994, the related statement of revenue and expenses, and the fund accountability statements relating to the loan fund and operating expenses for the period from August 16, 1992 to October 31, 1994 of the National Bank for Development relating to funds received and costs incurred under the Small Enterprise Loan Fund Agreement financed by the United States Agency for International Development pursuant to the Small Enterprise Credit Project, Grant Agreement No. 263-0228. These financial and fund accountability statements are the responsibility of the National Bank for Development management. Our responsibility is to express an opinion on these financial and fund accountability statements 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 financial and fund accountability statements are free of material misstatement. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial and fund accountability statements. Our audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial and fund accountability statements 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 33 of Chapter 3 of Government Auditing Standards (1994 revision) 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 3, the accompanying financial and fund accountability statements have been prepared on a modified cash basis, which is a comprehensive basis of accounting other than generally accepted accounting principles. Consequently, revenues and expenditures are recognized when received or paid rather than when earned or

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incurred. Accordingly, the accompanying financial and fund accountability statements are not intended to present results in accordance with generally accepted accounting principles.

Our testing identified the following aggregate questionable costs as detailed in the accompanying financial and fund accountability statements i) US$ 693,110 in costs that are ineligible because they are not project related, unreasonable, or prohibited by the terms of the agreements; and ii) US$ 329,930 that are not supported with adequate documentation or did not have the required prior approvals or authorizations. The basis for questioning costs are set forth in the Financial and Fund Accountability Statements-Audit Findings section of this report.

In our opinion, except for the questioned costs of $ 1,023,040 the financial and fund accountability statements referred to above present fairly, in all material respects, the National Bank for Development's assets, liabilities and project fund as of October 31, 1994, project revenue and expenses, and funds received and costs incurred under the Small Enterprise Loan Fund Agreement pursuant to the Small Enterprise Credit Project, Grant Agreement No. 263-0228 for the period from August 16, 1992 to October 31, 1994 in conformity with the cash basis of accounting described in Note 3.

This report is intended for the information of the management and others within the National Bank for Development and the United States Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

April 10, 1995

National Bank For Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Statement of Assets as of October 31, 1994 (Note 3)

Current assets:	
Cash (Note 5)	$ 5,387,296
Loans receivables - net of provision for doubtful accounts of $61,717 (Note 6)	6,725,855
Other accounts receivable	15,134
Total current assets	12,128,285
Fixed assets:	
Vehicles	333,930
Furniture and equipment	522,905
Less accumulated depreciation	(228,254)
Net fixed assets	628,581
Total assets	$ 12,756,866

See the accompanying notes to the financial and fund accountability statements.

National Bank For Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Statement of Liabilities and Project Fund as of October 31, 1994 (Note 3)

Current liabilities:	
Saving deposits due to borrowers	$ 948,507
Interest on borrowers' savings deposits	25,708
Late payment and insurance (Note 2)	455,746
Other accounts payable	102,093
Total current liabilities	1,532,054
Deferred revenue	1,083,669
Project fund:	
Loan fund (Note 2)	9,146,286
Excess of revenue over expenses	994,857
Total project fund	10,141,143
Total liabilities and project fund	$ 12,756,866

See the accompanying notes to the financial and fund accountability statements.

National Bank For Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Statement of Revenue and Expenses (Note 3)
for the Period August 16, 1992 to October 31, 1994

Revenue:		
Funds provided for operating expenses by USAID/Egypt		$ 2,642,243
Expenses paid directly by USAID/Egypt		7,753
Revenue generated from loans:		
Interest	$ 1,039,647	
Transportation fees	194,697	
Late payment interest and other revenue	68,786	1,303,130
Total revenue		$ 3,953,126
Expenses:		
Salaries	$ 2,032,896	
Training	185,523	
Other direct costs	394,759	
Depreciation	228,254	
Provision for bad debts	61,717	
Interest on borrowers' savings deposits	55,120	
Total expenses		2,958,269
Excess of revenue over expenses		$ 994,857

See the accompanying notes to the financial and fund accountability statements.

National Bank For Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Small Enterprise Loan Fund (Note 2)

Fund Accountability Statement (Notes 3 and 4)
For the Period August 16, 1992 to October 31, 1994

Source of funds:				
Receipts from USAID/Egypt			$	9,146,286
Funds provided from:				
Outstanding savings as of 10/31/94				948,507
Insurance and late payment fees collected from borrowers (Note 2)				455,746
Revenue (Note 2):				
Interest	$ 1,039,647			
Transportation fees	194,697			
Late payment interest and other revenue	68,786			1,303,130
Accounts payable				433
Total funds provided				11,854,102
Use of Funds:				
Outstanding loans as of 10/31/94		$ 6,787,572		
Less cost of outstanding loans		(1,083,669)		5,703,903
Interest expense on savings deposits from project inception to 10/31/94		55,120		
Less provision for interest as 10/31/94		(25,708)		29,412
Operating expenses for Sept. and Oct. 1994				292,956
Excess of expenses as of August 31, 1994 not funded directly by USAID/Egypt				248,828
Accounts receivable				944
Total use of funds				6,276,043
Fund balance				5,578,059
Less operating expenses paid from loan fund and reimbursed by USAID/Egypt during January 1995				(190,763)
Total available as cash (Note 5)			$	5,387,296

See the accompanying notes to the financial and fund accountability statements.

National Bank for Development

Audit of Local Expenditures, Incurred Under
The Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Operating Expense Fund (Note 2)

Fund Accountability Statement (Notes 3 and 4)
For the Period August 16, 1992 to October 31, 1994

		Questioned Costs (Note 7)	
		Ineligible	Unsupported
Receipts			
USAID/Egypt (Note 2)	$ 2,642,243	-	-
Expenses paid directly by USAID	7,753	-	-
	2,649,996		
Expenditures			
Vehicles	333,930	$ 33,956	-
Office equipment and furniture	522,905	-	-
Salaries	2,032,896	629,123	$ 293,618
Training	185,523	24,613	
Other direct costs	394,759	5,418	36,312
Total expenditures	3,470,013	693,110	329,930
Accounts receivables	14,190	-	-
Less:			
Expenditures for September and October 1994	(292,956)	-	-
Excess of expenditures as of August 31, 1994 not funded directly by USAID/Egypt	(248,828)	-	-
Accounts payable	(101,660)	-	-
Net disbursements	2,840,759	-	-
Expenditures reimbursed by USAID/Egypt during January 1995	(190,763)	-	-
Balance	$ 0	$ 1,023,040	

See the accompanying notes to the financial and fund accountability statements.

National Bank for Development

Audit of Local Expenditures, Incurred Under
The Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project Grant Agreement No. 263-0228

Notes to the Financial and Fund Accountability Statements

Note 1: Project Activities

Grant Agreement No. 263-0228 between the Government of Egypt and the United States Agency for International Development Mission in Egypt (USAID/Egypt) funds the Small Enterprise Loan Fund Agreement (SELFA) which was signed between the National Bank for Development and USAID/Egypt. The purpose of the SELFA is to provide loans to small enterprises located in the Greater Cairo Metropolitan Area through a loan fund administered by NBD (the "Project"). The Agreement also provides funds for the start up of costs, operational expenses, vehicles, equipment and furniture related to the administration of the SELFA.

Note 2: Small Enterprise Loan Fund Agreement (SELFA)

Loan Fund

Through the SELFA, the National Bank for Development (NBD) was appointed as the trustee for the Small Enterprise Loan Fund ("Loan Fund"). The Agreement provides US $ 11,150,000 for the loan Fund. Through the Loan Fund, NBD will make available loans to small enterprise borrowers meeting certain eligibility requirements. At present, thirteen NBD branches located through the Greater Cairo Metropolitan Area are implementing the Project. Principal and interest earnings repayments made by borrowers are redeposited in the loan fund with the intention to sustain the Project. As of October 31, 1994 USAID/Egypt has provided $ 9,146,286 (LE 30,731,520) to NBD relating to the Loan Fund.

Borrowers are required to deposit an amount equivalent to 10% of the loan in a NBD interest bearing savings account. The account pays an annual interest rate of 10%.

NBD charges an effective rate of 29.75% on all of the Project loans, which is as follows:

An interest rate of 16%/annum equivalent to the maximum allowable market rate in Egypt.

A fee of 3% to cover transportations costs of the Project lending staff. Interest and transportation fees are recorded as project revenues when paid by borrowers (i.e., received by NBD).

A penalty fee of 6% to cover potential late payments. When repaying the loan, the borrower is entitled to a refund of the penalty fee. When the borrower remits payments past the due date, the penalty fee is calculated for the late period and

recognized as project revenue. The difference between the 6% penalty fee and the actual penalty fee is refunded to borrower. As of October 31, 1994 penalty fees outstanding are $ 163,043.

An insurance fee of 4.75%, a contingency fund used to pay off the outstanding balance should the borrower die with an additional amount given to the surviving spouse to defray burial expenses. This fee does not constitute revenue to the Project but rather provides an allowance for life insurance. As of October 31, 1994, the outstanding balance for collected insurance fees is $ 292,703.

The Loan Fund becomes the property of NBD once NBD makes a deposit of LE10,000,000 into the Loan Fund. This deposit is to be made once any of the events described below under "Operating Expenses" occurs.

Operating Expenses

The Small Enterprise Loan Fund Agreement stipulates that operating expenses will be financed by USAID either: **i)** for a maximum of eighteen months after the date the first loan is made from the Loan Fund; or **ii)** until loans equivalent to US$ 11,150,000 in Egyptian Pounds have been made from the Loan Fund; or **iii)** until a determination has been made by USAID and NBD that NBD has reached the point of "Operational Break Even"; whichever event occurs first. Operational Break Even according to the agreement is defined as "the operating income (revenue) earned during a single continuous thirty day period divided by operating expenses incurred during the same thirty day period is equal to or greater than one."

USAID/Egypt Project officers and management of NBD focused on the Operational Break Even as the primary event finalizing USAID/Egypt funding. Based on a calculation by NBD management, Operational Break Even was reached on October 1994. However, USAID/Egypt provided the LE equivalent of $ 2.85 million, the maximum amount obligated to NBD for operating expenses as of August 1994 (the last $ 190,000 was received by NBD during January 1995), thereby finalizing USAID/Egypt's obligation to fund NBD's operating expenses related to the SELFA.

Note 3: Basis of Presentation

The financial and fund accountability statements have been prepared on the basis of cash receipts and disbursement except for the provision for doubtful accounts and fixed assets depreciation. Consequently, revenues and expenditures are primarily recognized when received or paid rather than when earned or incurred.

Note 4: Loan Fund and Operating Expenses - Fund Accountability Statements

Project fund accountability statements should provide identification of the revenues less expenditures applicable to the Project and reconcile such activity to cash on hand and/or in bank accounts. The loan and operating expense fund accountability statements in this report show the funds provided by USAID/Egypt, the revenue generated from the loan fund, expenditures and use of funds reconciled to the cash balance.

Note 5: Cash

As of October 31, 1994, the balance of cash is comprised of the following:

Cash on hand	$ 126,572
Cash in National Investment Bank	896
National Bank for Development bank accounts:	
Operating expense fund	60,947
Loans	580,475
Savings	958,908
Revenues	919,767
Collected installments	2,739,731
Total available as cash	$ 5,387,296

Note 6: Provision for Doubtful Accounts/Delinquent Loans

Provision for doubtful accounts is calculated as 5% of the interest income determined in accordance with the accounting basis described in Note 3. Outstanding loans are considered overdue when their due dates have expired and the borrowers have defaulted on the loan payments. As of October 31, 1994, the provision for doubtful accounts is $61,717 (LE 207,370) and the overdue loans are $ 62,065 (LE 208,538), which represent 1% of the outstanding loans.

Note 7: Exchange Rate

Expenditures incurred in local currency (LE) have been converted into US Dollars ($) at an average exchange rate of LE 3.36 to US$ 1 for the audit period. The rate has been determined based on the average rate for 1993 and 1994, using information provided by USAID/Egypt.

Note 8: Questioned Costs

Incurred questioned costs are presented in the fund accountability statements in two separate categories: ineligible and unsupported. Questioned costs are expenditures that we have determined are not in accordance with the Grant Agreement, SELFA, or other applicable USAID/Egypt regulations or are not supported by adequate documentation. "Ineligible" costs are deemed to be unallowable because they are not program related, unreasonable, or prohibited by the Agreement or applicable laws and regulations. "Unsupported" costs are expenditures which are not supported by adequate documentation or did not have required prior approval or authorizations.

Our audit identified $ 1,023,040 in aggregate questioned costs, $ 693,110 as ineligible costs and $ 329,930 as unsupported costs. The summary of questioned costs follows and the basis for questioning specific costs are set forth in the "Audit Findings" section of this report.

National Bank for Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Summary of Audit Findings

Finding No./Budget Element	Questioned Cost		Questioned Cost (US $ Equivalent)	
	Ineligible	Unsupported	Ineligible	Unsupported
	LE	LE	$	$
Salaries				
Finding No. 1	2,113,858	986,560	629,123	293,618
Vehicles				
Finding No. 2	114,092	-	33,956	-
Training				
Finding No. 5	29,960	-	8,917	-
Finding No. 7	52,740	-	15,696	-
	82,700		24,613	
Other Direct Costs				
Finding No. 4	-	122,008	-	36,312
Finding No. 5	18,204	-	5,418	-
	18,204	122,008	5,418	36,312
Total Questioned Costs	2,328,854	1,108,568	693,110	329,930
Total	LE 3,437,422		$ 1,023,040	

National Bank for Development
Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit
Grant Agreement No.

Fund Accountability Statements

Audit Findings

Finding No. 1: Salaries

During the review of salaries, we identified that not all of the amount disbursed and reported as salaries related to payments actually received by Project employees, and that part of this amount is maintained by the bank as a contingency. Questioned costs are as follows:

a) As of October 31, 1994, a balance of $ 413,487 (LE1,389,315) is outstanding relating to unsupported contingencies. NBD has not provided sufficient documentation to support the use of this contingency. The related funds were transferred out of the separately maintained USAID/Egypt account and are currently commingled with general funds. We understand from the Project Director that, these amounts will be utilized for bonuses and other related personnel costs earned during the period but not yet remitted.

b) Payments of bonuses to the Steering Committee which is comprised of the NBD Chairman, Project Director and NBD Senior Officers in the amount of $ 64,583 (LE217,000). NBD's provided support consisted of minutes from the Steering Committee approving the bonuses, but no documents were provided to support the basis used to determine these bonuses. The amounts appear excessive considering the loan fund has just recently reached operational break even.

c) Payment of clothes for Headquarter employees of $ 595 (LE 2001).

d) Headquarter employees assigned to the project are also responsible for the management of projects funded by other than USAID donors. The total of their salaries are being paid with Project funds. As of October 31, 1994, the total salaries plus bonuses paid to Headquarter employees is LE 698,034. Total loans disbursed for all the projects managed by the Headquarter Office during the audit period was LE 99,654,656, out of which LE 75,708,195 related to the Project (76%). Based on this assumption, which we believe is reasonable, the other projects should share 24% of Headquarter salaries which is $49,859 (LE167,528).

e) Administrative services were paid to the Bank in the amount of $ 100,599 (LE 338,014). No documents were provided regarding the basis of the calculation nor its appropriateness as a salary cost.

f) Payment of bonuses of $ 44,743 (LE 150,336) to other NBD Department employees which according to the Project Director were assisting the project. No documents were provided to support the basis for awarding these bonuses to non Project personnel nor was there evidence of receipt of the amounts by the employees.

g) Bonuses to Project employees for $ 214,225 (LE 719,800) based on the Bank's General Assembly decision and $ 34,650 (LE 116,424) based on Project Steering Committee decision. No documents supporting NBD policies relating to these payments were provided.

SECP, Project Grant Standard Provisions annex 2, Section B.5 requires the Grantee to maintain books, records, documents and other evidence related to the Project and the Agreement adequate to show without limitation, all costs of goods and services acquired under the Project. Furthermore, the Small Enterprise Loan Fund Agreement (SELFA), Section 2.3 indicates that salaries, incentives, social insurance and other personnel related expenses to be paid are only for personnel utilized by NBD solely to administer the loan fund.

Section 6.5 of SELFA states that no fee, commission or consideration of any nature shall be paid on behalf of NBD or any of its officers or employees in connection with the Agreement.

USAID/Egypt was billed for ineligible expenses in the amount of $ 629,123 (LE2,113,858) and unsupported expenses in the amount of $ 293,618 (LE986,560).

Finding No. 2: Procurement of Vehicle

The Project remitted funds for the procurement of a Japanese made car in the amount of $17,102 (LE57,463). In addition, customs duties and sales taxes for this vehicle in the amount of $ 16,854 (LE 56,629) were paid with Project funds. SECP Project Grant Provisions Annex, Article 6 states that any motor vehicles financed under the Grant will be of US origin. The procurement plan approved by USAID/Egypt specifically related to the Project indicated that vehicles to be purchased would be Egyptian-made. Furthermore, SECP, Section B.4 of the Project Grant Standards provisions Annex 2 states that Grant will be free from any taxation or fees. The Project Director indicated that purchase of Japanese car and payment of taxes were implicitly approved by USAID. He cited a letter issued by USAID/Egypt Controller's Office requesting Egyptian Tax authorities to grant NBD with an exemption of taxes on the Project's acquisition of vehicles and equipment. No specific approval by USAID/Egypt was identified relating to the acquisition of this vehicle.

As a result, USAID/Egypt was billed ineligible expenses in the amount of $33,956 (LE114,092).

Finding No. 3: Procurement of Computers

Finding deleted.

Finding No. 4: Rent of Vehicles to the Project

NBD charges the Project on monthly basis LE 1,200/each for thirteen cars (used by the branch Project managers). The only supporting documents is a contract, for each car, between the Bank and the Project stating the monthly rent. We identified that most of these vehicles are models years, 1980 through 1984. While the monthly charges seem to be reasonable when compared with prices charged by car rental companies, we question

these charges because these vehicles are old and if a 25% depreciation rate (reasonable for Egypt) is applied by NBD, the book value considering the age of the cars, would be totally depreciated. In addition, if the bank continues charging rent to the Project, the cost would be higher than the cost of actually purchasing newer cars. NBD did not provide documents evidencing that USAID/Egypt approved the rent of the cars. Project Grant Standard Provisions Annex 2, Section B.5 requires the Grantee to maintain books, records, documents and other evidence related to the Project Grant and to the agreement adequate to show without limitation, all cost of goods and services acquired under the Project.

USAID/Egypt was billed unsupported cost of $ 36,312 (LE122,008).

Finding No. 5: Ineligible Expenses

The Project remitted payments of ineligible expenses such as the costs of parties, gifts, obituaries in newspapers, unrelated Project expenses, flowers, tips, antennas and radios for the Project microbuses, meals, entertainment costs, and awards in the amount of $14,335 (LE 48,164). As cited under Federal Acquisition Regulations, Chapter 31, these type of expenses are unallowable. These expense were reported in the fund accountability statement uner the following budget line items: $ 5,418 (LE18,204) under other direct costs and $ 8,917 (LE 29,960) under training. According to the Project Director, these expenses are reasonable and necessary for the business and provide incentives and rewards for the good performance of employees.

USAID/Egypt was billed ineligible costs as identified above.

Finding No. 6: Unsupported Expenses

Finding deleted.

Finding No. 7: Procurement of Training Equipment

During our review of training expenses, we identified that payments for training equipment were remitted with Project funds, in the amount of $ 23,625 (LE79,380). While USAID/Egypt approved training plan did not include a list of equipment to be acquired, we found that the equipment procurement plan included the purchase of equipment for $ 7,929 (LE 26,640) only. Therefore, $ 15,696 (LE52,740) is considered ineligible. In addition, this equipment was procured during June 1994, subsequent to the period when the significant training of Project employees took place. Project Implementation Letter No. 1 of the Small Enterprise Loan Fund Agreement requires NBD to obtain USAID/Egypt approval on training expenses prior to disbursement. Furthermore, Section B.5 of the Project Grant Standards Provisions, Annex 2 requires NBD to maintain records and documents and other evidence related to the Project to show without limitation that proper procurement procedures were applied.

USAID/Egypt was billed ineligible expenses in the amount of $ 15,696 (LE52,740).

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مراسلو أرثر أندرسن وشركاه
محاسبون قانونيون وخبراء تنظيم وإدارة
زملاء وأعضاء جمعية المحاسبين والمراجعين المصرية

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

Report of Independent Public Accountants On Internal Control Structure

We have audited the statements of assets, liabilities and project fund as of October 31, 1994, the related statement of revenue and expenses, and the fund accountability statements relating to the loan fund and operating expenses for the period from August 16, 1992 to October 31, 1994 of the National Bank for Development relating to funds received and costs incurred by the Small Enterprise Loan Fund Agreement financed by the United States Agency for International Development pursuant to the Small Enterprise Credit Project, Grant Agreement No. 263-0228, and have issued our report thereon dated April 10, 1995.

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 financial and fund accountability statements are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 33 of Chapter 3 of Government Auditing Standards (1994 revision) 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 engagement, we considered the National Bank for Development's internal control structure as it relates to the Small Enterprise Loan Fund Agreement to determine our procedures for the purpose of expressing an opinion on the financial and fund accountability statements and not to provide assurance on the internal control structure.

The management of the National Bank for Development 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. Among the objectives of the 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; transactions are executed in accordance with management's authorization

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and in accordance with the terms of the agreements; and transactions are recorded properly to permit the preparation of the financial and fund accountability statements referred to above in conformity with the basis of accounting described in Note 3 to the financial and fund accountability statements. 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 in the following categories: cash control, loan approval, loan disbursements and collections, revenue recognition, procurement practices, personnel and payroll, and general accounting records. For the internal 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 a certain matter involving the internal control structure and its operation that we consider to be a reportable condition 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 judgment, 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 audit disclosed deficiencies regarding the cash management, at certain branches of NBD, which we believe is a reportable condition. Our discussion regarding this matter is detailed in finding No. 1 of this report.

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 the 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 being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control structure and its operation that we consider to be material weaknesses.

In addition, we noted certain matters involving the internal control structure and its operation that we have reported to the management of the National Bank for Development and the United States Agency for International Development Mission in Egypt in a separate letter dated April 10, 1995.

This report is intended for the information of the management and others within the National Bank for Development and the United States Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

April 10, 1995

National Bank for Development

Audit of Local Expenditures Incurred Under the
Small Enterprise Development Loan Fund Agreement
Small Enterprise Credit Project, Grant Agreement No. 263-0228

Internal Control Structure
Findings

Finding No. 1: Cash Management

During the performance of our audit ,we noted some deficiencies in the cash management at certain branches of NBD implementing the Project as follows:

a. The Bab-El Louk Branch records identify that cash collected is not deposited in total during the next available working day. We understand that some of the cash was used for loan disbursement during the day, which is contrary to NBD's policies.

b. It appears that the Giza Branch does not deposit the amounts collected from borrowers on a daily basis because it uses this money to disburse loans, contrary to the bank's established policies, which require that the loans be disbursed from a bank account specifically established for this purpose.

c. The Heliopolis Commercial Branch deposits the cash collected only on a weekly basis instead of a daily basis.

d. Finding deleted.

e. For all branches, we identified that the cashiers are located in the same room with the rest of the branch employees and the money collected is placed and counted on cashiers' desk. The offices are crowed and further aggravated by the presence of borrowers, thus increasing the risk of cash not being properly handled. In addition, we identified that due to the excessive amount of money being collected, the cashiers request assistance from other employees, including office boys, to count the money.

f. In the Kasr El Nile Branch, the accountant is also the cashier.

We recommend that NBD ensure that:

1. cash collected from borrowers is deposited during the next available working day and is not used directly for operations;

2. Recommendation deleted.

3. appropriate facilities be assigned to the project cashiers, to facilitate their cash counting duties. Further, cashiers should not have other responsibilities which do not allow for proper segregation of duties.

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

Report of Independent Public Accountants On Compliance With Laws and Regulations

We have audited the statements of assets, liabilities and project fund as of October 31, 1994, the related statement of revenue and expenses, and the fund accountability statements relating to the loan fund and operating expenses for the period from August 16, 1992 to October 31, 1994 of the National Bank for Development (NBD) relating to funds received and costs incurred by the Small Enterprise Loan Fund Agreement financed by the United States Agency for International Development pursuant to the Small Enterprise Credit Project, Grant Agreement No. 263-0228, and have issued our report thereon dated April 10, 1995.

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 financial and fund accountability statements are free of material misstatement.

We did not have an external quality control review by an unaffiliated audit organization as required by Paragraph 33 of Chapter 3 of Government Auditing Standards (1994 revision) 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 grants applicable to the Small Enterprise Loan Fund Agreement is the responsibility of the National Bank for Development's management. As part of obtaining reasonable assurance about whether the financial and fund accountability statements are free of material misstatement, we performed tests of the National Bank for Development's compliance with certain provisions of laws, regulations, contracts and grants. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions contained in statutes, regulations, contracts, or grants that cause us to conclude that the aggregation of misstatements resulting from those failures or violations could be material to the financial and fund accountability statements. The effects of

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Finding No. 1 surrounding expenditures incurred and provisions established by the National Bank of Development which were certified as salaries in reporting to the United States Agency for International Development in Egypt are included as questioned costs in the fund accountability statement referred to above.

Finding No. 2 regarding the United States Agency for International Development in Egypt's determination as to the appropriate period to cease funding NBD's operating expenses is a matter not direclty affecting the fair presentation of the fund accountability statements.

We considered these material instances of noncompliance in forming our opinion on whether the National Bank for Development's financial and fund accountability statements are presented fairly, in all material respects, in conformity with the basis of accounting described in Note 3 to the financial and fund accountability statements, and this report does not affect our report on the financial and fund accountability statements dated April 10, 1995.

Except as described above, the result of our tests of compliance indicate that with respect to the items tested, the National Bank for Development complied, in all material respects, with the provisions referred to in the fourth paragraph of this report, and with respect to items not tested, nothing came to our attention that caused us to believe that the National Bank for Development had not complied, in all material respects, with those provisions.

This report is intended for the information of the management and others within the National Bank for Development and the United States Agency for International Development. This restriction is not intended to limit the distribution of this report which is a matter of public record.

April 10, 1995

National Bank for Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Development Loan Fund Agreement
Small Enterprise Credit Project, Grant Agreement No. 263-0228

Compliance with Agreement Terms And Applicable Laws and Regulations

Findings

Finding No. 1: Expenses reported under the "Salaries" line item

During the performance of our audit we identified that the National Bank for Development (NBD) reported as Project expenditures under the "Salaries" line item, **i)** payment of bonuses for the Project's Steering Committee (comprised of the NBD Chairman, Project Director and NBD General Managers), **ii)** payment identified as NBD administrative costs, **iii)** bonuses to different NBD departments, and **iv)** provision for contingencies. The costs related to this finding are included as questionable costs in finding No. 1 of the Financial and Fund Accountability Statements - Finding Section.

We recommend that:

a. NBD provide supporting documents on the basis used for the payment of the expenses listed above and the expected use of the contingency in accordance with established policies.

b. USAID/Egypt evaluate this information and determine if the expenses are necessary for the Project and reasonable.

c. NBD reimburse to USAID/Egypt any amounts not substantiated as Project expenses, including a realistic assessment of the need of the established contingency as of October 31, 1994 of $ 413,487 (LE 1,389,315).

Finding No. 2 USAID/Egypt Funding Period

The Small Enterprise Loan Fund Agreement stipulates that operating expenses will be financed by USAID either: **i)** for a maximum of eighteen months after the date the first loan is made from the Loan Fund; or **ii)** until loans equivalent to US$ 11,150,000 in Egyptian Pounds have been made from the Loan Fund; or **iii)** until a determination has been made by USAID and NBD that NBD has reached the point of "Operational Break Even"; whichever event occurs first. Operational Break Even according to the agreement is defined as "the operating income (revenue) earned during a single continuous thirty day period divided by operating expenses incurred during the same thirty day period is equal to or greater than one."

We understand that USAID/Egypt Project officers and management of NBD focused on the Operational Break Even as the primary event finalizing USAID/Egypt funding. Based on a calculation by NBD management, Operational Break Even was reached on October 1994. However, USAID/Egypt provided the LE equivalent of $ 2.85 million, the

maximum amount obligated to NBD for operating expenses as of August 1994 (the last $190,000 was received by NBD during January 1995), thereby finalizing USAID/Egypt's obligation to fund NBD's operating expenses related to the SELFA.

Considering the above three events, we believe that the second event was ignored (i.e. loans equivalent to US $ 11,150,000 ,make from the Loan Fund). Based on internally generated information, it appears that the loans equivalent to US $ 11,150,000 had been made from the loan fund by June 1994.

The Loan Fund becomes the property of NBD once NBD make a deposit of LE10,000,000 into the Loan Fund. This deposit is to be made once any of the events described above occurs.

We recommend that:

USAID/Egypt take into consideration the above events as stipulated in the SELFA in determining when USAID/Egypt funding should have ceased and when NBD should provide the LE 10,000,000 deposit into the Loan Fund. For information purposes, USAID/Egypt provided NBD with $ 190,763 during January 1995 relating to NBD Project operating expenses incurred through August 1994.

Appendix A

National Bank For Development

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Management Comments

The National Bank For Development (NBD) responses to Allied Accountants

findings incurred in the period between August 16,1992 to October 31,1994

under the

Small Enterprise Loan Fund Agreement (SELFA),
Grant Agreement No. 263-0228

The National Bank For Development received the draft report of audit findings on June 13, 1995, and noted the following:

* None of the finding commented about the accounting system or the internal control system.
* None of findings commented about reviewing the portfolio.
* Most of the findings received were related to salaries, bonuses, administrative expenses and some findings were related to procurement and training.

We had a primary sitting to verify some preliminary findings before the draft was issued.

Our responses about NFA report on the National Bank For Development (NBD) local expenditure incurred under the Small Enterprise Credit Program (SECP), Grant Agreement No. 263-0228 are as follows:

Comments on Fund Accountability Statements Audit Findings.

Finding No. 1/A (Salaries) :

"As of October 31, 1994, a balance of $413,487 (L.E. 1,389,315) is outstanding relating to unsupported contingencies. NBD has not provided sufficient documentation to support the use of this contingency. The related funds were transferred out of the separately maintained USAID/Egypt account and are currently commingled with general funds. We understand from the Project Director that, these amounts will be utilized for bonuses and other related personnel costs earned during the period but not yet remitted."

NBD acknoweledges the figure mentioned in your report, which amounted to LE 1,389,315 Egyptian Pounds ($413,487), and wishes to emphasize that the Bank applied the same policy followed by the Rural Small Scale Enterprise Project (RSSE) to the Greater Cairo project (SECP). This policy is supported by the following attachments:

(1) A letter of May 7, 1990 which ACDI sent to USAID concerning expensing bonus and administrative expenses (Attachment No. 1). (The letter has USAID's approval dated May 17,1990)

(2) The audit report received by the bank from Shawky & Co., Arthur Andersen &Co. Accountants dated January 31, 1991 concerning the RSSE project. Shawky & Co. stated that all of the Bank's expenses concerning the RSSE project were within limits and stated that the costs in carrying out the purposes of the agreement were reasonable, allocable and allowable in accordance with the terms of the agreement amendment and standard provisions on any negotiated advances understanding on a particular cost item (Attachment No. 2).

(3) Exhibit (D) pages 2,3 and 4 of the SELFA Agreement which indicate that the Greater Cairo Project (SECP) builds on the Successful Rural Small Scale Enterprise (RSSE) Pilot Credit Activity (Attachment No. 3).

(4) The NBD letter sent to USAID dated December 21, 1992 detailing the breakdown of salary components the charged percentages of each and their usage. (Attachment No. 4).

(5) The project's organizational chart, one of the SELFA Annexs, Exhibit (J) refers to the role played by the steering committee which acts in a policy making and supervisory role for the Greater Cairo Project and the NBD SME Department. (attachment No. 5)

The amount mentioned (LE 1,389,315) was allocated on an accrual basis in order to meet expenses which were related to the period covered by NBD's fiscal year. The balance is a decreasing amount representing our standard banking expenses in the mentioned line items as follows :

A- LE 637,118 on December 31, 1994

B- LE 310,553 on March 31, 1995
C- LE 186,410 on April 19, 1995

Documentation of the expenses charged on this balance are attached as they concern settlements of the year 1994 made after October 31, 1994 (Attachment No. 6)

Attachments for Finding 1/A provide 2 months of documentation as a sample, since it is not practical to supply all of the months. NBD retains identical records of summary documentation for each sub-line item, including Bank claims for reimbursement for services and payments incurred in support of SECP during the audited period. There are specific schedules detailing payments to each individual/supplier. These documents are available for the auditors to examine at any time.

Following are more details on the NBD system and banking cost standard which has been consistently applied the RSSE since pilot phase. The details clarify NBD's compensation package composed of the five salary components.

A- Tax And Insurance Allowance : (24% of the basic salary)

This component is allocated to cover social insurance and taxes on bonuses and incentives to all employees working under the project. At the end of each fiscal year a final settlement is calculated with both the tax and the insurance departments, and NBD pays all accrued balances from the previous year.

Unfortunately the unified tax law was issued without a clear basis for calculating such tax. We therefore retain the balance until the final settlement for the year 1994.

The balance was as follows :

* LE 116,370 as of December 31, 1994
* LE 42,628 as of March 31, 1995
* LE 5,034 as of April 19, 1995

The letter concerning the settlement of the funds of the previous period is attached (Attachment 8).

B- Medicare Allowance : (LE 50 per employee per month)

This component is allocated to cover all medicare expenses for employees working under the project, as the Bank is not taking part in any insurance system. NBD applies a system based on actual medical costs. Due to the nature of using its own system, there has to be a continuous balance for such allowance in order to meet emergencies.

The balance was as follows :

* LE 132,267 as of December 31, 1994

* LE 83,059 as of March 31, 1995
* LE 69,239 as of April 19, 1995

C- Per diem, Living Cost And Overtime Allowance : (60% of the basic salary)

This component is allocated to meet the annual increase in salaries including the living cost which increased by 45% during the last year. The letter specifying the settlement to the project's employees for the audit period is attached (attachment No. 7). This allowance is also allocated as perdiems to the project's follow-up staff and as an overtime allowance to the project's employees.

The balance was as follows:

* LE 169,792 as of December 31, 1994
* LE 123,051 as of March 31, 1995
* LE 119,676 as of April 19, 1995

D- Administrative Cost Allowance : (50% of the basic salary)

This component is allocated to cover all services done for SECP by certain departments in NBD as (Personal Affairs Department, Financial Affairs Department, Control and Administration Affairs Department), and bonuses and allowances disbursed to the members of the project Steering Committee. This is the only allowance used for services performed for SECP by the Bank's departments outside the SME department. This is according to the organizational chart of the project and the accompanying function narrative. (Attachment No. 5)

The balance was as follows:

* LE 10,855 as of December 31, 1994
* LE 10,105 as of March 31, 1995
* LE 10,105 as of April 19, 1995

E- Monthly Bonuses And Incentives Allowance : (100% of the basic salary)

This component is allocated to disburse bonuses and monthly incentives based on performance for permanent employees working under the project according to the Steering Committee decision and the Bank Board of Directors.

The balance was as follows :

* LE 207,834 as of December 31, 1994
* LE 51,710 as of March 31, 1995
* LE 17,644 as of April 19, 1995

NOTE: NBD wishes to emphasize that it stopped disbursing the balance from the contingency for bonuses after receiving the letter sent by USAID dated 19/4/1995. All funds disbursed between October 31, 1994 and April 19, 1995

were settlements concerning the year 1994.

The project's payroll policy is clearly established. USAID was informed by a letter dated 21/12/1992 with the breakdown of salary components (Attachment No. 4) built on the same payroll policy of the pilot project (RSSE) which was previously audited by Shawky & Co. as of January 31,1991 (Attachment No. 2).

The balance of all salary component contingencies as of April 19, 1995 was LE 186,410 distributed as follows :

*	LE 5,034	Tax And Insurance Allowance
*	LE 69,239	Medicare Allowance
*	LE -17,644	Monthly Bonuses And Incentives Allowance
*	LE 10,105	Administrative Cost Allowance
*	LE 119,676	Perdiem, Living cost And Overtime Allowance

All funds disbursed from these allowances concern the Project's employees except the funds disbursed from the administrative cost allowance (50% of the basic salary) which are disbursed for the direct administrative services offered by some of the Bank's other departments and that represents a part of the project salary system. This is due to the letter sent to the USAID as of December 21, 1992 which determined the usage of this item in supervision, management and other direct services offered to the project. A statement of disbursed funds from the provisions balance since Oct 31, 1994 for all 5 salary components is attached (Attachment No. 9).

Finding No. 1/B:

"Payments of bonuses to the Steering Committee which is comprised of the NBD Chairman, Project Director and NBD Senior Officers in the amount of $ 64,583 (LE 217,000). NBD's provided support consisted of minutes from the Steering Committee approving the bonuses, but no documents were provided to support the basis used to determine these bonuses. The amounts appear excessive considering the loan fund has just recently reached operational break even".

In reviewing finding 1/B, NBD agrees that the amount disbursed was LE 217,000 ($ 64,583) since the start-up of the project until October 31, 1994. This amount was from the 50% salary component allocated for administrative cost (item D above). Therefore, the funds were disbursed from the allowance of the administrative services formed in the project which is a part of the salaries component system identified in the letter sent to USAID on December 31, 1992. This letter informed USAID of the use of this item in supervision, management and direct administrative services offered to the project. This principle was agreed upon by USAID according to the letter sent to NBD from ACDI concerning the RSSE project.

The funds were disbursed due to the decision taken by the project Steering Committee. Copies of the steering Committee decisions are attached (Attachment No. 10), as it is the only body which decides upon offering the project's employees bonuses or incentives or profits due to the bank's policy in implementation and the fixed policies of monitoring the project. The Steering Committee is the monitoring body which decides the policy and evaluates the project's performance.

The NBD SME Department, which administers the SECP Project also administers funds from 3 other bilateral donors and one former USAID project (RSSE). It is Bank policy that the Steering Committee qualifies for bonuses for setting policy and supervising the SME credit programs as such programs are not part of the regular Bank budget and are normally conducted beyond banking working hours. Attachment 28 provides evidence of the Steering Committees creation and operation well before SECP. Included in that attachment are the NBD directive which created the Committee and minutes of the first Steering Committee meeting which were held on July 14, 1988. Steering Committee minutes regarding the other projects indicate that Steering Committee bonuses are similar proportionately for all projects. (Attachment No. 10)

Finding No. 1/C:

"Payment of clothes for Head Quarter employees of $ 595 (LE 2001)".

After reviewing this finding, NBD found that this amount was disbursed under the other direct costs account and not allowances. It was for buying appropriate uniforms for employees specially assigned to accompany the visitors of the project on their field tours during the International Conference for Population Development (ICPD) (Attachment No. 11)

This amount of money disbursed for the uniform amounted to LE 2,001 (It was disbursed only once).

Finding No. 1/D :

Headquarter employees assigned to the project are also responsible for the management of projects funded by other than UNSAID donors. The total of their salaries are being paid with project funds. As of October 31, 1994, the total salaries plus bonuses paid to Headquarter employees is LE 698,034. Total loans disbursed for all the projects managed by the Headquarter Office during the audit period was LE 99,654,656, out of which LE 75,708,195 related to the project (76%). Based on this assumption, which we believe is reasonable, the other projects should share 24% of Headquarter salaries which is $49,859 (LE 167,528)".

The basis for the above assumption needs modification since the other projects implemented through NBD started a long time ago (About six years). These projects are stable and the size of the allocated funds for these projects is small. Therefore, their activity was insignificant when compared to the Greater Cairo project which was in the implementation phase, and requiring full attention of Headquarter staff.

Additionally, we would like to emphasize that the Greater Cairo project is actually only charged by salaries of employees working under the SECP project at the H.Q.O. The desk work of Greater Cairo personnel represents 92% of the work in the SME department by H.Q.O. based on relative increases in the outstanding balance in the last year (Attachment No. 12).

This attachment clearly shows the activity of the Greater Cairo project compared with other projects from 16/9/1993 through 31/10/1994.

Finding No. 1/E:

"Administrative services were paid to the bank in the amount of $100,599 (LE 338,014). No documents were provided regarding the basis of the calculation nor its appropriateness as a salary cost".

The project paid these funds as installments under settlement to the Bank for direct services offered by the departments to the project including the Inspection Department, the Financial Department, the Personnel Department, the Legal Affairs Department and the Administrative Affairs Department. These funds are paid from the administrative cost allowance (50% of the basic salary) which is a component of the salaries system. USAID was informed by a letter dated 21/12/1992 with this item which determines the use of this allowance in supervision, management and the direct administrative services offered to the project.

Attachments:

* A letter of June 30, 1995 from the NBD Financial Department to the SECP emphasizing the rules and basis by which these funds were calculated and the final settlement with the Bank concerning this matter (Attachment No. 13).

* The letter sent to USAID including the bank's policy concerning the breakdown of salary components (Attachment No. 4)

* The original approval on this principle which was received by ACDI concerning the RSSE project (Attachment No. 1).

Finding No. 1/F :

"Payment of bonuses of $44,743 (LE 150,336) to other NBD department employees which according to the Project Director were assisting the project. No documents were provided to support the basis for awarding these bonuses to non project personnel nor was there evidence of receipt of the amounts by the employees".

The funds disbursed were for administrative services provided to SECP by the Inspection Department, Financial Department, Personnel Department, Legal Department and Administrative Affairs Department in the form of bonuses to the employees of such departments which amounted to 150,336 Egyptian Pounds.

We would like to emphasize the following:

First: After reviewing the LE 150,336 figure, we found that its correction is 78,000 Egyptian Pounds disbursed into two installments, LE 56,000 as of 8/1993 and LE 22,000 as of 10/1993. This amount includes a notable mixing between some of this figures in finding no. 1/E which is the difference that amounted to LE 72,336.

Second: These funds were disbursed after the approval of the Project Steering Committee taken during its meeting as of 8/1993 and 10/1993. A copy of the Committee's decision is attached (Attachment No. 14).

Third: The project's policy in the pilot stage provided for disbursal of funds to non-SECP employees who offer direct services to the project. On 11/1993 the project's Steering Committee changes this policy by supplying the bank such funds in the form of installments under settlement until the final settlement for such services. This is the new basis for calculating this cost (Attachment No. 13).

Fourth: The78,000 Egyptian Pounds wasn't deducted from the monthly bonuses and incentives allowance described in "E" above which is only for project employees, but was deducted from the administrative cost allowance (50% of the basic salary) according to the project's policy. Disbursals for administrative cost allowance have not exceeded the prescribed percentage.

Finding No. 1/G :

"Bonuses to project employees for $214,225 (LE 719,800)based on the bank's General Assembly decision and $34,650 (LE 116,424) based on Project Steering Committee decision. No documents supporting NBD policies relating to these payments were provided".

We'd like to emphasize the following :

First: There is a clear policy applied by the bank and the project concerning offering bonuses and incentives to the project's employees. These bonuses and incentives are disbursed on board of director approval concerning all the bank's employees and all the sectors and therefore apply to the project. (Attachment no. 16).

Second: The disbursement of bonuses and incentives are based on NBD Policy (Attachment no. 15).

Third: The funds disbursed due to the project Steering Committee depend on the rules and basis that organize its disbursement. The decisions of the Steering Committee are attached (Attachment No. 10). The Steering Committee is the only monitoring body other than the board of directors which decides the issue of disbursing bonuses and incentives to the project's employees.

Fourth: All the funds disbursed to the project's employees are due to their productivity and to the extent they reach desired goals.

Note: All these funds were only disbursed to the project's employees.

Summary : All amounts identified in Finding No. 1 were disbursed for employees working under the project except for the administrative cost allowance (50% of the basic salary) which represents a portion of the salary component of the project. USAID was informed by a letter dated 21/12/1992 in which it was determined to use this item for direct supervision, management, service and administrative costs under the project.

Note: Disbursing of bonus from the provision for salaries has been suspended in response to USAID's letter dated April 19th, 1995 to NBD (Attachment No. 27)

Finding No. 2 (Procurement of Vehicle):

"The project remitted funds for the procurement of a Japanese made car in the amount of $ 17,102 (LE 57,463). In addition, customs duties and sales taxes for this vehicle in the amount of $16,854 (LE 56,629) were paid with the project funds. SECP Project Grant Provisions Annex, Article 6 states that any motor vehicles financed under the Grant will be of US origin. The procurement plan approved by USAID/Egypt specifically related to the project indicated that vehicles to be purchased would be Egyptian-made. Furthermore, SECP, Section B.4 of the Project Grant Standards Provisions Annex 2 states that Grant will be free from any taxation or fees. The Project Director indicated that purchase of Japanese car and payment of taxes were implicitly approved by USAID. He cited a letter issued by USAID/Egypt Controller's Office requesting Egyptian Tax authorities to grant NBD with an exemption of taxes on the project's acquisition of vehicles and equipment. No specific approval by USAID/Egypt was identified relating to the acquisition of this vehicle".

"As a result, USAID/Egypt was billed ineligible expenses in the amount of $ 33,956 (LE 114,092)."

After reviewing this finding about the purchase of the Japanese-made vehicle which totally amounted to LE 114,092, we'd like to emphasize the following :

* The project purchased the vehicle from the vehicles allowance received from USAID and there is a letter sent to USAID concerning the vehicle purchase.(Attachment No. 17).

* After this, USAID sent a letter to the tax department for sales tax exemption on this vehicle which the Bank considered to be an implied acceptance on purchasing the vehicle (Attachment No. 18).

* The bank clears the whole matter to the tax department that refused the demand concerning the sales tax exemption on this vehicle (Attachment No. 19) where, the total customs and the sales tax amounted to 56,629 Egyptian Pounds.

Finding No. 3 (Procurement of computers):

"While performing a physical inspection of the computers procured with project funds, we identified that three computers and three printers were not available at the project premises. We were informed that two of them were delivered to NBD branches which are unrelated to the project, and that one computer and printer were maintained at the home of NBD's computer manager. The cost of the computers and printers is $ 11,526 (LE 38,728). Two of the computers were listed in the vendor's invoices but not billed and were provided to NBD, analogous to a vendor discount. We believe this amount should have been credited to the cost of the computer equipment purchased with USAID/Egypt funds. Project Grant Standards Provisions Annex 2, Section B.3 indicates that any resources financed under the grant will be devoted to the project until its completion".

"According to the Project Controller, two computers and printers were received as a compliment from the vendor providing the project computers. Therefore, he cites that these items were not directly paid with project funds and that the third computer is used by the computer manager solely for project purposes".

"USAID/Egypt was billed for ineligible costs of $ 11,526 (LE 38,728)".

After reviewing this finding concerning the two computers used in Sharkia RSSE Project (Belbis and Kafr Sakr branches)which totally amounted to LE 38,728, we'd like to emphasize the following:

* Two computers were given to NBD as a compliment from the vendor providing the project computers.

* The two computers were returned to the project in the SECP H.Q.O. as of June 28, 1995. A copy of the reply memorandum from Belbis and Kafr Sakr branches is attached (Attachment No. 20). Therefore, the two computers are available now in the H.Q.O. and are being used in the project.

Finding No. 4 (Rent of Vehicles to the project):

"NBD charges the project on monthly basis LE 1,200 each for thirteen cars (used by the branch project managers). The only supporting documents is a contract, for each car, between the bank and the project stating the monthly rent. We identified that most of these vehicles are models years, 1980 through 1984. While the monthly charges seem to be reasonable when compared with prices charged by car rental companies, we question these charges because these vehicles are old an if a 25% depreciation rate (reasonable for Egypt) is applied by NBD, the book value considering the age of the car, would be totally depreciated. In addition, if the bank continues charging rent to the project, the cost would be higher than the cost of actually purchasing newer cars. NBD did not provide documents evidencing that USAID/Egypt approved the rent of the cars. Project Grant Standard Provisions Annex 2, Section B.5 requires the grantee to maintain books, records, documents and other evidence related to the project grant and to the agreement adequate to show without limitation, all cost of goods and services acquired under the project".

"USAID/Egypt was billed unsupported cost of $ 36,312 (LE 122,008).

After reviewing this finding concerning renting cars as of January 1994 till October 1994 which totally amounted to LE 122,008, we'd like to emphasize the following:

First: There is an item of the other direct costs allowance in the "Other Direct Costs Supporting Information" (Attachment No. 29) which is used as per diem for the project's mangers for follow-up and collection operations (with a total LE 1,200 per manager monthly). There is no allowance permitting the purchase of vehicles for the branch managers' and assistant branch managers' transport.

Second: The project choose between renting vehicles for those managers from car rental companies where the value of renting a vehicle isn't less than 2,500 Egyptian Pounds (monthly) under any circumstances or renting these cars from the bank by 1,200 Egyptian Pounds. The project deducts the maintenance expenses for these vehicles in addition to the insurance value from this amount which becomes sometimes less than 900 Egyptian Pounds (monthly).

* A copy of the offers of the different vehicle renting companies is attached (Attachment no. 21).

It is clear that renting the vehicles from the Bank is much better than renting them from car rental companies. It is also much better than paying monthly per diem to the branches managers , since they would not be able to rent cars for the LE 1,200 per month allowed. The cars rented from NBD are available on a 24 hour basis for use of the project.

Finding No. 5 (Ineligible Expenses):

"The project remitted payments of ineligible expenses such as the costs of parties, gifts, obituaries in newspapers, unrelated project expenses, flowers, tips, antennas and radios for the project microbuses, meals, entertainment cost, and awards in the amount of $ 14,708 (LE 49,419). As cited under Federal Acquisition Regulations, Chapter 31, these type of expenses are unallowable. These expenses were reported in the fund accountability statement under the following budget line items: $5,418 (LE 18,204) under other direct costs and $9,290 (LE 31,215) under training. According to the Project Director, these expenses are reasonable and necessary for the business and provide incentives and rewards for the good performance of employees".

"USAID/Egypt was billed ineligible costs as identified above".

After reviewing this finding, we have the following comments on the 31,215 Egyptian Pounds charged to training.

A- LE 3,808 representing the value of additional meals for our Christian colleagues in the training courses during Ramadan. Two meals were provided to Muslim trainees during the Ramadan training. The additional LE 3,808 was a for a third meal authorized for Christian trainees. Meals authorized for either Christian or Muslim trainees are below USAID and NBD authorized per diem rates.

B- LE 1,255 representing the Medicare expenses disbursed to some of the trainees during the training courses which was charged on the training allowance due to the training budget (Attachment No. 23). This is due to the fact that the trainees were not yet Bank employees, and could not receive medical funds as part of the regular salary component.

C- LE 23,205 representing the value of prizes (rewards)distributed on the project's employees for the best performance at Ismailia conference which was held after six months from the start-up of implementation in order to identify the implementation results, the evaluation of the performance and identifying the problems that previously faced the project's employees. At the end of the conference, prizes (rewards) based on performance were presented to the best credit officers (male and female) in the project, the best project manager, the best branch and others. A statement of what was disbursed is attached (Attachment No. 24).

D- LE 1,430 representing the value of tips offered to the hotel workers.

E- LE 1,517 representing the value of perdiem for the project drivers who accompanied the trainees during Ismailia conference.

From the above mentioned, it is clear that the amounts mentioned by the auditors staff and which they considered to be or ineligible are actually amounts disbursed to the project employees during the training courses, included in the training process, and considered to be

a matter of necessity.

We have reviewed the second part of finding No. 5 amounting to 18,204 Egyptian Pounds. We found that these expenses represent only 1.1 %of the total other direct expenses for the same period. These are actual documented expenses which were approved by the members of the expense committee in the branches or in the H.Q.O.. These expenses are well within limit and were incurred during 18 months with a monthly average of 1,000 Egyptian Pounds covering thirteen branches and Headquarters. All these expenses are customary and reasonable according to the banking expenses standard followed by NBD and are as follows:

LE 2,531 representing the cost of printing photos for borrowers profiles (for preparing the annual book of the project).

LE 2,675 for preparing mobile banking micro-bus vehicles by providing it with curtains for sun protection and accessories.

LE 122 representing tips to some of the workers for removing and installing the furniture of the branches and the H.Q.O.

LE 400 are parking fees for the Project's vehicles in front of the H.Q.O

LE 1,200 representing the value of the daily newspaper distributed on the branch managers due to the basis followed in the bank.

LE 1,320 representing obituaries in newspapers for the death of some of our colleagues relatives who are working under the project.

LE 4,800 for stationery (pens).

LE 1,830 for lunch expenses.

LE 659 for telephone invoices.

LE 39 for inputs (for the place of making coffee and tea "buffet").

LE 1,406 for public relations and reception parties.

LE 26 for taxes and fees.

LE 1,149 for bonuses and incentives concerning special duties.

LE 18,204 (total)

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Finding No. 6 (Unsupported Expenses):

"During our testing of operating expenses, we identified payments for expenses that were not supported with documentation in the amount of $525 (LE 1,763). Project Grant Standard Provisions Annex 2, Section B.5 requires the grantee to maintain goods, records, documents and other evidence related to the Project Grant and to the Agreement adequate to show without limitation, all cost of goods and services acquired under the project".

Concerning the unsupported expenses which totally amounted to 1,763 Egyptian Pounds, we'd like to inform you that after reviewing such expenses, we confirm that there are documents supporting the amounts charged and they are available for you (Attachment No. 25). Besides, all expenses are recorded in the bank's records at the branches and H.Q.O. The percentage of these unsupported expenses is .1% of the total other direct costs.

Finding No. 7 (Procurement of Training Equipment):

"During our review of training expenses, we identified that payments for training equipment were remitted with project funds, in the amount of $23,625 (LE 79,380). While USAID/Egypt approved training plan did not include a list of equipment to be acquired, we found that the equipment procurement plan included the purchase of equipment for $ 7,929 (LE 26,640) only. Therefore, $ 15,696 (LE 52,740) is considered ineligible. In addition, this equipment was procured during June 1994, subsequent to the period when the significant training of project employees took place. Project implementation letter no. 1 of the Small Enterprise Loan Fund Agreement requires NBD to obtain USAID/Egypt approval on training expenses prior to disbursement. Furthermore, Section B.5 of the project grant standards provisions, Annex 3 requires NBD to maintain records and documents and other evidence related to the project to show without limitation that proper procurement procedures were applied".

"USAID/Egypt was billed ineligible expenses in the amount of $15,696 (LE 52,740)".

After reviewing this finding, we'd like to emphasize the following :

First : There wasn't any specified amount of fund concerning the purchase of training equipment to the project in the grant agreement. Actually, we are unable to identify the actual source of the 26,640 Egyptian Pound figure used by the auditors.

Second: The excess amount for training equipment was due to the increase in prices and the need of the project for such training equipment which was very important for continuing the training process and all of it was within the training budget (Attachment No. 26).

Third: The training is ongoing which means that the training equipment is completely used by the project staff.

Comments on Recommendations Related to Internal Control Structure Findings

Finding No. 1 Cash Management

"We recommend that NBD ensure that:

1. cash collected from borrowers is deposited during the next available working day and is not used directly for operations;

2. all the employees that have responsibilities for cash collection and custody, including the branch manager, be covered by fidelity bonds;

3. appropriate facilities be assigned to the project cashier, to facilitate their cash counting duties. Further, cashiers should not have other responsibilities which do not allow for proper segregation of duties."

NBD Comment:

NBD has implemented recommendation No. 1, however NBD determined in the past that the cost of fidelity bonds as specified in recommendation No. 2 would be prohibitive. Accordingly, such bonds will not be purchased.

Regarding recommendation No. 3, all possible effort has been exerted to provide adequate cash counting facilities, and cashier responsibilities which did not allow for proper segregation of duties were assigned to others.

Comments on Recommendations Regarding Findings on Compliance with Agreement Terms and Applicable Laws and Regulations.

Finding No. 1 : Expenses reported under the "Salaries" line item.

"We recommend that:

a. NBD provide supporting documents on the basis used for the payment of the expenses listed above and the expected use of the contingency in accordance with established policies.

b. USAID/Egypt evaluate this information and determine if the expenses are necessary for the Project and reasonable.

c. NBD reimburse to USAID/Egypt and amounts not substantiated as Project expenses, including a realistic assessment of the need of the established contingency as of October 31, 1994 of $ 413,487 (LE 1,389,315)."

NBD Comment on each recommendation:

a. NBD has supplied the supporting documents as part of this response.

b. NBD believes all expenses incurred have been necessary and reasonable, but we cannot speak for USAID/Egypt.

c. Although NBD understands the need to reimburse USAID for unsubstantiated project expenses, it believes sufficient documentation and clarification has been supplied with this response to substantiate all questioned expenses.

Finding No. 2, USAID/Egypt Funding Period.

We recommend that:

"USAID/Egypt take into consideration the above events as stipulated in the SELFA in determining when USAID/Egypt funding should have ceased and when NBD should provide the LE 10,000,000 deposit into the Loan Fund. For information purposes, USAID/Egypt provided NBD with $ 190,763 during January 1995 relating to NBD Project operating expenses incurred through August 1994.

NBD Comment:

We believe that the second event specified as a cut off mechanism for operating funds refers to the amount disbursed by USAID for loan funds. Since USAID has to date disbursed $ 9,146,286 for loan funds, the cut off level of $ 11,500,000 has not been reached.

Appendix B

NATIONAL BANK FOR DEVELOPMENT

Audit of Local Expenditures Incurred Under
the Small Enterprise Loan Fund Agreement
Small Enterprise Credit Project
Grant Agreement No. 263-0228

Auditor's Response to Management Comments

Our comments below address the National Bank for Development's (NBD) responses provided regarding the questioned costs as identified in the Fund Accountability Statements Audit Findings-Section, and the findings on internal control and compliance identified in the Internal Control Structure and Compliance with Laws and Regulations - Audit Finding Sections regarding to our audit of the National Bank for Development. The findings for which NBD provided relevant supporting documents have been deleted and marked as such in the Fund Accountability Statements. Internal Control Structure, and Compliance with Laws and Regulations - Audit Finding Sections. For those findings in which either insufficient supporting documents were provided or we do not agree with the adequacy of the NBD response, the findings were either unchanged or modified as discussed below.

Fund Accountability Statements

General Comment: NBD provided an enormous amount of documents in response to this finding. However, NBD did not provide through this documentation any specific responses to the finding in which we could determine the allocability or reasonableness of the questioned costs. We provide all comments on this finding as follows:

Finding No. 1: Salaries

a) Outstanding balance of unsupported contingency
NBD did not provide sufficient evidential matter to prove that the contingency balance as of October 31, 1994 was used to pay expenses that were incurred prior to October 31, 1994.

b) Payment of bonuses to Steering Committee,
e) Administrative services paid to the Bank, and
f) Payment of bonuses to other NBD Department employees

NBD's response states that these bonuses and administrative service costs are proper in accordance with a letter submitted to USAID/Egypt dated December 21, 1992. This letter stated that the salary components of the Bank's personnel assigned to the Project were comprised of a base salary plus a rate of 234% of the base salary for fringe benefits, allowance, and incentive bonuses.

We do not agree with NBD's response due to the following reasons:

- NBD was not able to provide evidence to demonstrate USAID/Egypt's approval or concurrence with NBD's proposed salary components as described in the above-mentioned letter dated December 21, 1992.

- During our fieldwork, we tested the calculation of the fringe benefits, allowance, and incentive bonuses rate on a selected basis for some employees and one month to assess whether NBD was following the proposed policy in the above-mentioned letter. The results of our testing showed that NBD did not follow this policy.

- The expenditures questioned under paragraphs (b) and (f) are bonuses to NBD employees who did not appear to perform work related to the Project. We were not provided any evidential matter to support NBD's position that the personnel performed work related to the Project.

- NBD represented that the payment of administrative costs (paragraph (e)) relates to administrative support services that were provided to the Project by several of the Bank's internal service departments. Generally, the nature of these expenses are not classified as salary costs. Furthermore, the approved budget for the Project did not authorize any costs related to administrative services.

- Section 6.5 of SELFA states that no fee, commission, or consideration of any nature shall be paid on behalf of NBD or any other of its officers or employees.

- Salaries paid to Project employees already include all of the benefits and allowances paid by the Bank to its employees.

c) Payment of clothes for Headquarters employees
This expense represents payment of clothes for Bank representatives to wear while they represented the NBD at a population development convention. NBD did not provide any evidential matter to demonstrate that the Bank's participation in this convention would benefit the Project. As result, this expense remains as an ineligible cost.

d) Lack of allocation of Headquarters employees' salaries, who are assigned to both this Project and other projects that are funded by organizations other than USAID
NBD's response indicates that the Headquarters employees in the SME (Small and Medium Enterprise) department incurred 92% of their labor on the Project and 8% of their labor to other unrelated projects. This calculation was based on NBD's average outstanding loan balances for both the Project and other projects during the audit period. We believe that our position is a more accurate method of allocating these costs because it emphasizes the main cost driver of these salary costs, which is the origination of the loan process. NBD did not provide us with the Bank's policy related to the allocation of costs. As result, these costs remain questioned.

g) Bonuses to project employees
During the audit, we were provided with the documents evidencing that Project employees received bonus payments. However, NBD did not provide sufficient supporting documents to determine that the bonuses were authorized and computed in accordance with the Bank's policy. As a result, these costs remain questioned.

Finding No. 2: Procurement of Vehicle
NBD's documents attached to their response do not support USAID/Egypt approval for the procurement of a Japanese made vehicle and payment of the related taxes with Project funds. Thus, these costs remain questioned.

Finding No. 3: Procurement of Computers
NBD provided supporting documents related to this finding. Accordingly, we have deleted this finding.

Finding No. 4: Rent of Vehicles to the Project
As discussed in our finding, the monthly usage charges for these vehicles are reasonable based on prices charged for new vehicles by local car rental companies. However, we noted that the model years of most of the underlying vehicles are 1980-1984. Using the applicable Egyptian depreciation rate of 25% per year, the net book value of these vehicles, as of the beginning of our audit period, is zero. In addition, we were not permitted access to the Bank's records to determine the methodology of the monthly usage charge calculation, if any. Per the Federal Acquisition Regulation (FAR), Part 31.205-11(l), no depreciation or rental charge is allowed on property that is fully depreciated unless an advance agreement exists. NBD did not provide sufficient supporting documents. As a result, these costs remain questioned.

Finding No. 5: Ineligible Expenses
NBD provided supporting documents related to $374 (LE 1,255) of these costs. For the remaining costs, NBD did not provide supporting documents. The majority of the expenses questioned in this finding were incurred under the training costs line item. However, these expenses are unallowable per FAR 31.205-14 (entertainment costs), 31.201-3 (reasonableness), and/or Project Implementation Letter No.1 of the Small Enterprise Loan Fund Agreement, which requires NBD to obtain USAID/Egypt approval for all training-related expenses prior to disbursement. As a result, all of these costs except the $374 mentioned above, remain as ineligible expenses.

Finding No. 6: Unsupported Expenses
NBD provided supporting documents related to this finding. Accordingly, we have deleted this finding.

Finding No. 7: Procurement of Training Equipment
NBD did not provide documents evidencing USAID approval for the procurement of this training equipment, as required by Project Implementation Letter No. 1 of the Small Enterprise Loan Fund Agreement. As a result, these costs remain questioned.

Internal Control Structure

Finding No. 1: Cash Management
NBD agrees with recommendation No. 3 in this report. However, they did not provide supporting documents to demonstrate that this recommendation has been implemented.

Compliance with Laws and Regulations

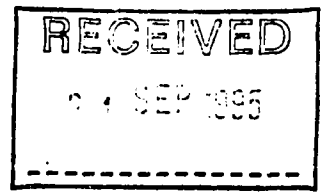
Finding No. 1: Expenses Reported Under the Salaries Line Item
NBD's response and the documents that they provided do not provide sufficient evidential matter to support the payment of expenses billed to USAID/Egypt under salaries. Our finding remains unchanged.

Finding No. 2: USAID/Egypt Funding Period
NBD's response does not address this finding. As a result, our finding remains unchanged.

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

September 20, 1995



MEMORANDUM

To : Lou Mundy, RIG/A/C

From : Shirley Hunter, OD/FM/FA

Subject : Draft NFA Report on The National Bank for Development, Local expenditures Incurred under the Small Enterprise Credit Project, Grant Agreement No. 263-0228.

Following is the Mission response to the subject draft audit report.

Recommendation No. 1:

Finding No. 1.d ($49,859): Mission requests that this finding be reduced to $17,659 based on the justification provided in the Project Officer's memo dated 9/12/94). The reduction is mainly based on using the method proposed by NBD to allocate a portion (8.5%) of the head office salaries to the other non-project activities which have benefited from the head office level of effort.

Finding No. 2 ($33,956): This amount represents the cost of a Japanese car ($17,102) and the related custom duties and sales tax ($16,845). Mission believes that the Grant Agreement standard provisions related to the above issues are not applicable to the GOE Special Account funds used to purchase goods and services under this Project (See attached LEG E-Mail dated 9/14/95 regarding source and origin requirements). Mission also believes that these funds are considered part of the GOE contribution to the Project, and as stated by the Project Officer in his memo dated 9/12/95, were properly used for the project purpose. Based on the above, Mission requests that this finding be removed from the final audit report. Mission is working with the auditee to resolve and close the remaining findings.

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Cairo, Egypt

Recommendation 2:

Attached is a copy of a letter to NBD requesting them to address the material non-compliance issues identified in the audit report. Based on this action, Mission requests resolution of Recommendation 2.

Please issue the final report.

Att: a/s above

USAID

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

MEMORANDUM

DATE: September 12, 1995

TO: Shirley Hunter, OD/FM/FA
Sherif Zohdy, FM/FA

FROM: Magdy Khalil, TI/FI

SUBJECT: Financial Audit of the National Bank for Development, Local Expenditure Incurred Under the Small Enterprise Credit Project, Grant No. 263-0228. Audit Final Draft Report Dated August 13, 1995.

We would like to note that all operational costs, and accordingly all related questioned costs in this audit, are financed from the GOE special account (FT 800), as evidenced by the Grant Agreement budget and the SELFA agreement budget (copy attached).

While the Mission believes that those funds should be monitored and independently audited, it is also the Mission's opinion that the resolution of such findings should not be subject to the same standards applicable to US dollar appropriated funds.

The following are the actions taken by the Mission to resolve some of the findings under Recommendation Number 1 in the subject audit report:

1. Finding No. 1.d, $ 49,859 (LE 167,528): While we agree that a portion of the HQ salary expense should have been financed by the other small business lending programs that the NBD manages through the HQ unit of SECP in Cairo, it appears that the auditors calculations did not consider an important factor. The significant point in this discussion, is the level of effort and scale related to the institutional development devoted to a new program, which USAID/SECP required.

While SECP started end-use lending in July 1993, the other programs had by then reached a level of maturity and institutional efficiency that required a minimum level of supervision and support from the HQ in Cairo. This is evidenced by the fact that during the audit period the number of outstanding USAID/SECP loans increased nearly 800%, while the other programs collectively increased their outstanding loans by only 65%. This is an indication of the excessive institutional development efforts provided by the SECP/HQ to the USAID program during the audit period and redirected to small business lending activities by the end of the audit period.

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The auditors based their calculation on the total value of loans given during the period, while the NBD proposed an alternative methodology based on the net change in the outstanding loan balances during the audit period. Because the institutional development of SECP, although significant, is not quantifiable, and not considered in both methodologies; Mission tends to give more weight to the NBD's method of calculation. The NBD's method results in a reduced percentage of allocation to the other programs, which had a minimum share of the effort expended in the task of institution building, during the audit period.

Based on the above Mission requests that the finding be reduced to LE 59,333 ($ 17,659), representing 8.5% of the salary expense of HQ employees of SECP.

Finding No.2, Procurement of vehicle: This finding is based on an alleged violation of source and origin regulations and the use of grant funds to finance customs duties.

Mission believes that the terms and provisions related to the above issues are applicable only to US dollar appropriated funds; and not to GOE special account funds used to purchase goods or services under this project.

Mission also believes that these funds are considered part of the GOE contribution to the project, and were properly used to serve the project purpose (see attached E-Mail from LEG). Therefore, we request that this finding be removed.

TI/FI and FM are working closely with the auditee to resolve/close the remaining findings under recommendation No.1, in addition to the internal control and non-compliance findings covered under recommendations No.2 and No.3.

: Magdi Khalil@TI.FI@CAIRO
: Bruce Boyer@RIG.A@CAIRO
   Mary-Alice Kleinjan@LEG.OFF@CAIRO
c:
om: Vicki Moore@LEG.AD@CAIRO
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gdy, you are correct the source and origin requirements stated in the grant reement do not apply to GOE owned local currency provided from the Special count. I have passed your memo on to Mary Alice to review. Thanks, Vic

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

September 20, 1995

Mr. Abdel Fattah Salem
General Manager
SEC Project Director
National Development Bank
2a Midan Omar Makram
Cairo, Egypt

Subject: Audit of the National Bank of Development Local Expenditures Incurred Under the Small Enterprise Credit Project, Grant No. 263-0228 - Draft Report dated August 13, 1995

Dear Mr. Salem:

You have been provided a copy of the subject audit report, which contains two recommendations.

Recommendation No. 1 deals with ineligible and unsupported costs, and Recommendation No. 2 deals with material non-compliance issues identified in the audit report.

Please review the recommendations, and submit to me your response by October 20, 1995, explaining the corrective actions planned or taken by NBD, to address Recommendation No. 2.

Thank you for your cooperation.

Sincerely,

Shirley Hunter
Office Director
Financial Analysis Division
USAID/Cairo

Att: a/s

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