PD-ABM-320

Regional Inspector General for Audit
Cairo, Egypt

Audit of USAID/Egypt's Monitoring of Small Projects

Report No. 6-263-96-002
November 27, 1995

USAID

CAIRO, EGYPT

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

November 27, 1995

MEMORANDUM

TO : Director USAID/Egypt, John R. Westley

FROM : RIG/A/C, Lou Mundy Lou Mundy

SUBJECT: Audit of USAID/Egypt's Monitoring of Small Projects

This is our report on the subject audit. We considered the Mission's comments on our draft report, and have included them in their entirety in Appendix II.

The report contains three recommendations for your action. All of the recommendations are resolved as of the date of this report and may be closed when planned actions have been implemented.

We wish to express our appreciation to the Mission for the cooperation and assistance it provided on this assignment.

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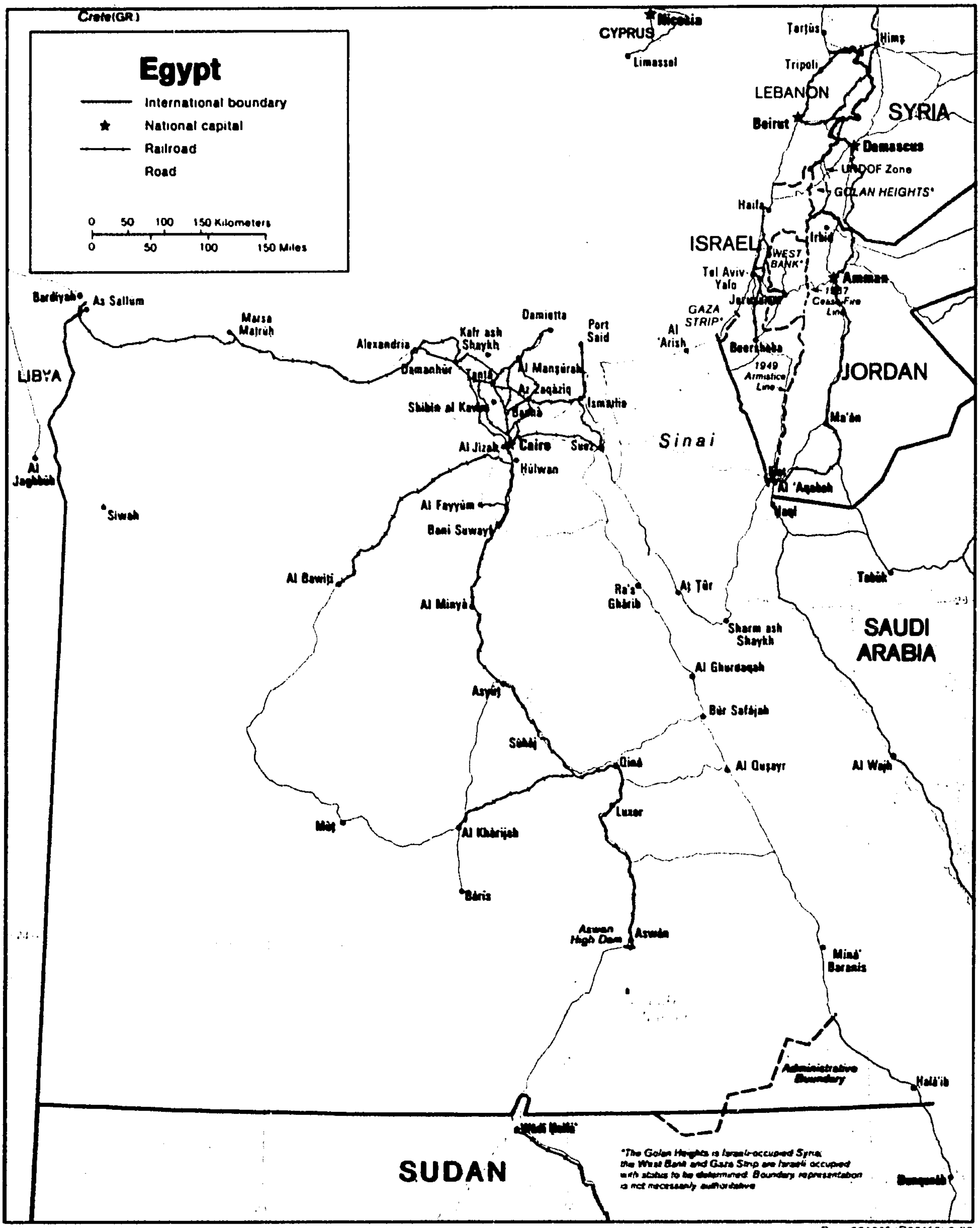
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EXECUTIVE SUMMARY

The audit examines how well USAID/Egypt (Mission) monitors "small" projects—small being defined as projects having obligations of $25 million or less. The three projects reviewed by the audit have obligations of $35 million and authorizations totaling $45 million. The $10 million, five-year **Export Enterprise Development** project is designed to increase non-traditional exports produced by Egypt's private sector. The $25 million, six-year **Small Enterprise Credit** project is to establish a program to provide loans ranging from $75 to $1,470 to small and medium-sized enterprises. And the $10 million **Technical Support for Sector Policy Reform** project was to provide technical assistance to the host government in conjunction with the Mission's two-year, $400 million Sector Policy Reform program. [See page 1.]

The audit answered the following questions: (1) How were funds spent on these projects? and (2) Did USAID/Egypt monitor these projects to ensure that planned outputs and objectives were being achieved? [See page 2.]

As of June 1995, $14.8 million had been spent on the three projects. Funds were spent primarily on technical assistance ($5.6 million), a loan fund for the credit project ($5 million), and on operational expense support for a nongovernmental entity promoting exports ($3.1 million). [See page 3.]

For all three projects we found that USAID/Egypt was monitoring project activities to ensure that planned outputs and objectives were being achieved—except that in the Export Enterprise Development project a key indicator on exports generated by the project needed to be better defined, and in the Small Enterprise Credit project (in spite of otherwise impressive results), the Mission was not measuring whether a key project output, financial self-sufficiency, was being achieved. As for the Technical Support for Sector Policy Reform project, although USAID/Egypt was monitoring the project's activities, only general, non-specific outputs and objectives for the project had been established. [See page 5.]

The audit recommends that USAID/Egypt (1) establish baseline data on exports for firms assisted by the project (or develop an alternative indicator for the project objective); (2) measure whether the loan program was achieving financial self-sufficiency; and (3) establish specific outputs and objectives for the Technical Support project before any additional funds for the project are approved. [See pages 6, 11 and 13.]

The Mission generally agreed with the audit's findings. For the Export Enterprise Development project an evaluation team was already in country as of November 1995, at work on identifying "alternative performance indicators and/or the methodology for collecting...baseline information." For the loan program in the Small Enterprise Credit project the Mission was planning to first define just what "financial self-sufficiency" meant and then assess progress being made by the program. And for the Technical Support project the Mission acted expeditiously in approving in September 1995 a project paper supplement to strengthen the monitoring of the project. The supplement (1) clarifies the project's purpose, (2) establishes priorities for funding activities, and (3) sets up an "annual plan" process which will specify concrete, quantifiable outputs and benchmark dates. [See page 17.]

Office of the Inspector General
November 27, 1995

INTRODUCTION

Background

The audit examines how well USAID/Egypt (Mission) monitors "small" projects—small being defined as projects having obligations of $25 million or less. According to USAID/Egypt's records the three projects reviewed by the audit in the aggregate have obligations of $35 million (and authorizations totaling $45 million); as of June 1995, $14.8 million had been spent. The three projects are described briefly below.

The $10 million, five-year **Export Enterprise Development** project is designed to increase non-traditional exports produced by Egypt's private sector. The project, which started in January 1992, is to increase private sector exports by $75 million by means of the Trade Development Center (TDC), a nongovernmental organization funded by the project. As of March 1995 $4.3 million had been spent, and TDC reportedly had surpassed its interim (Phase I) objective of increasing Egyptian exports by $40 million.

The second project is the $25 million **Small Enterprise Credit** project. The six-year project, which began in 1991, is to establish a program to provide loans ranging from $75 to $1,470 to small and medium-sized enterprises.[1] By establishing 25 offices at branches of Egypt's National Bank for Development, the project is to make loans totaling $40 million over the project's life. As of March 1995, the Mission reported that the loan program had already made loans totaling $27 million, with a loan default rate of less than 1 percent—well within the project performance indicator of 1.5 percent.

The third project is the $10 million **Technical Support for Sector Policy Reform** project. This project (the project paper was signed August 1992) was to have been a three-year effort to provide technical assistance to the host government in conjunction with the Mission's two-year Sector Policy Reform (SPR) program. The SPR was to disburse $400 million to the Government of Egypt in return for carrying out 41 policy reform actions in four sectors (financial, fiscal, trade, and privatization). Per Mission

[1] *Here and throughout the report we use an exchange rate of $1.00 = LE3.4.*

records as of June 1995, 37 of these reforms had been carried out, and $380 million had been disbursed. The Technical Support project had spent $3.5 million (out of the $10 million obligated) as of that date. In July 1994 the project's length was increased to six years, with the Mission planning to use remaining funds for follow-on activities in policy reform. At the time of the audit the Mission was preparing a project paper supplement for the Technical Support project to increase funding to $50 million.

Audit Objectives

Pursuant to our fiscal year 1995 audit plan, the Office of the Inspector General for Audit in Cairo performed an audit to answer the following audit objectives:

(1) How did USAID/Egypt spend funds for these three small projects?

(2) Did USAID/Egypt monitor small project activities to ensure that planned outputs and objectives were being achieved?

Appendix I contains a discussion of the scope and methodology for the audit.

REPORT OF AUDIT FINDINGS

Our answers to the following audit objectives are qualified to the extent of the effect, if any, of not having received written representations for the audit from USAID/Egypt officials directly responsible for the audited activities. Appendix I includes a discussion of this qualifier.

How did USAID/Egypt spend funds for these three small projects?

According to USAID/Egypt's accounting records, $14.8 million was spent as of June 30, 1995 for the three projects under audit. Funds were spent primarily on technical assistance ($5.6 million), on establishing a loan fund for the credit project ($5 million), and on operational expense support for the nongovernmental entity promoting exports ($3.1 million). (See table on the following page for expenditures by project.)

Of the $4.9 million spent for **Export Enterprise Development,** $3.1 million, or about 63 percent of total project expenditures, went to the Trade Development Center (TDC), the entity implementing the project. TDC's mission is to help increase Egypt's private sector exports by providing Egyptian firms with export promotion assistance. Most of the $3.1 million spent was for: salaries for TDC personnel; other direct costs such as office rent and operations; and product promotion, trade shows and seminars.

By far the largest expenditure under the **Small Enterprise Credit** project was the $5 million (78 percent of total project expenditures) used to establish a loan fund. This fund was used to provide loans to small and medium-sized enterprises in the Greater Cairo area. In addition to the $6.4 million of U.S. funds spent under the project, an additional $6.9 million in local currency from a joint U.S.-host government special account was also used for the project. These local currency funds consisted of $4.1 million in additional loan funds and $2.8 million for the loan program's operating expenses. Most of the $2.8 million allocated for operating expenses was spent to pay salaries to loan program personnel at the National Bank for Development, the entity which is implementing the program.

Of the $3.5 million spent under the **Technical Support** project, $2.4 million was used to fund an existing technical assistance contract under another USAID project, Partnership in Development. The primary purpose of that contract was to work with host government "holding companies" to identify government enterprises which would be candidates for privatization and to develop valuations for such enterprises. Most of the remainder of the funds were spent on studies: e.g., $421,000 for a study of Egypt's cotton textile industry and $142,000 for a study of price and market liberalization in Egypt.

The responsibilities for the three projects fell under two USAID/Egypt offices. The office of Trade and Investment was responsible for Export Enterprise Development and Small Enterprise Credit. The Economic Analysis and Policy office was responsible for the Technical Support project.

Expenditures for Three Small Projects

as of June 30, 1995

(unaudited)

		millions of dollars
Export Enterprise Development -		
Trade Development Center (TDC) expenses	$	3.1
Technical Assistance		1.8
	$	4.9
Small Enterprise Development -		
Loan Fund	$	5.0
Technical Assistance		1.4
	$	6.4
Technical Support for Sector Policy Reform -		
Technical Assistance	$	2.4
Studies, Conferences & Other *		1.1
	$	3.5

* *includes $36,422 for the "Monitoring Unit" at the Ministry of International Cooperation*

Did USAID/Egypt monitor small project activities to ensure that planned outputs and objectives were being achieved?

For all three projects we found that USAID/Egypt was monitoring project activities to ensure that planned outputs and objectives were being achieved—except that in the Export Enterprise Development project a key indicator on exports generated by the project needed to be better defined and in the Small Enterprise Credit project (in spite of otherwise impressive results), the Mission was not measuring whether a key project output, financial self-sufficiency, was being achieved. As for Technical Support for Sector Policy Reform, although USAID/Egypt was monitoring the project's activities, only general, non-specific outputs and objectives for the project had been established.

We concluded that Mission monitoring of these projects was adequate, especially considering the relatively small size of these projects. For the Export Enterprise Development project the Mission went to great lengths to monitor the financial operations of the private sector entity responsible for promoting exports. The Mission also required that, at a minimum, the entity retain some independent support for exports generated by the project. Likewise for the Small Enterprise Credit project we observed that the Mission was judiciously delaying expansion of the project to Upper Egypt pending implementation of certain management and system improvements. And for the Technical Support for Sector Policy Reform project, the Mission had hired a general manager to oversee the project's many activities and was tracking progress of these activities on spreadsheet software.

In summary, while Mission monitoring of project activities was adequate, the audit noted problems related to certain of the projects' output and/or purpose-level indicators. Since these problems were unique to each project, we will discuss them in separate sections below.

1. Export Enterprise Development

While monitoring of this project's activities was adequate, the audit nevertheless noted that a key indicator relating to the project's objective of increasing private sector exports by $75 million needed to be better defined. Specifically, the project is lacking a baseline from which to measure an increase in exports—and export data being reported is not entirely reliable. These problems will not allow the Mission to ensure that the project's planned objective is being achieved.

Although we were not able to determine definitively whether the export targets are being met—the Trade Development Center (TDC) reportedly had met its interim goal of increasing Egyptian exports by $40 million as of March 1995—our audit work did indicate that the project is achieving some of its planned results and that some companies have made inroads into new markets through TDC's help. A number of firms told us that TDC has helped them secure export sales they would not have otherwise attained. Such anecdotal information, however, does not replace the need to establish solid baseline data and to obtain reliable reporting on increases in exports.

Baseline data is needed for the
<u>Export Enterprise Development project</u>

USAID Handbook 3 requires projects to contain baseline data in order to measure the change that occurs as a result of project activities. For the Export Enterprise Development project, the objective of which is to increase exports for firms assisted by the project, the baseline data needed would be pre-project data on individual firm's exports. The project paper contained some macro-economic export data, but it did not (and could not) contain data for all the individual firms to be assisted. This data needs to be collected during the course of the project as firms are contacted for participation. Such baseline data were not collected because the Mission relied instead on unadjusted export data taken from various source documents generally provided by the assisted firms. This data did not consider the level of exports which the firms had experienced before project assistance. Although we were able to trace 92 percent of reported exports to such source documents, without baseline data one could not determine if the project's objective of increasing exports by $75 million was being achieved. Also, as a number of the firms being assisted exported the bulk of their output in any case, one could not tell whether the data being reported represented an overall increase in exports. In addition, due to a lack of clear guidance to the firms as to how data on exports were to be compiled, documented and reported, such data were not always consistent and reliable.

> **<u>Recommendation No. 1</u>: We recommend that USAID/Egypt establish baseline data for firms assisted by the project and provide clear guidance as to how data on increases in exports are to be compiled, documented and reported or develop an alternative indicator to better measure the increase in exports resulting from the project.**

<u>Discussion</u>

The Export Enterprise Development (EED) project was designed to expand foreign exchange earnings by increasing non-traditional exports from Egypt's private sector, the objective of the project being to increase private sector exports by $75 million in firms directly assisted by the project.[2] However, in order to monitor whether there is an increase in exports in firms assisted by the project, baseline data is necessary.

USAID Handbook 3 requires that every project contain baseline data, baseline data being defined as the "pertinent conditions at the time a project begins or as soon thereafter as practical."[3] These conditions are used as the starting point from which to measure project progress.

Although the EED project paper included some data on Egyptian exports, these were macro-economic, nationwide figures which could not be used as a basis for measuring project progress toward the objective of increasing the exports of individual firms.

Progress Reported to Date—The project is being implemented by the Trade Development Center (TDC). As of December 1994, TDC reported that its activities had generated a total of $37.1 million in exports in the companies assisted by the project (the original "Phase I" target of the project being to achieve $40 million in exports by March 1995). Although we were able to trace $34.1 million, or 92 percent of the total, to some sort of supporting document, (letters from the assisted firm or buyer, invoices, letters of credit, questionnaires, etc.),[4] we were unable to determine whether the project's export target was being met.

This was because the documents we reviewed, although providing some evidence of exports, did not demonstrate increases in a firm's exports. For example, among the firms reporting exports due to TDC assistance, we interviewed a number that said that they had exported 100 percent of their production, even before TDC assistance. (The Mission pointed out that Phase I of the project was in fact designed to work with "existing successful exporters.") However, we could not determine from available data whether TDC's assistance resulted in any net increase in exports for these firms, or whether exports reported as due to TDC simply replaced prior year export activity.

In addition, the data we reviewed, in spite of being provided by outside parties (companies or brokers), were not always reliable, nor were we always able to verify data which were provided. For example, almost 10 percent of the exports that TDC indicated it had generated through December 1994 was based on a single letter from a foreign

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[2] *The Mission noted in its response to this finding that there are seven other Phase I targets against which the project is being measured. This audit, however, only examined four: the project's main objective of increasing private sector exports, plus three output targets (see Scope & Methodology, Appendix I, page 2).*

[3] *USAID's new "Automated Directives System" (ADS) contains similar requirements.*

[4] *We found no third party support for eight percent ($3 million) of the $37.1 million in exports attributed to the project through December 1994.*

broker indicating that it had purchased $3.5 million in leather products from eight Egyptian firms. The time period of the purchases, however, in part preceded the start of the project. Furthermore, the letter did not say how much was purchased from each of the eight firms, making it impossible for us to individually verify these exports. We were able to contact and interview two of these firms. One of these two confirmed that it had made a sale to the broker for $173,669, but the other was unable to provide any useful information. Therefore, for the $3.5 million in reported exports made through this broker, we were able to independently verify only $173,669, or about 5 percent of the amount indicated in the broker's letter.

Other interviews also led us to question the overall reliability of the data on exports—and particularly whether what was being reported was an accurate representation of the increase in that company's exports due to TDC help. For example:

- The chairman at one company we visited advised us that the export figure reported by TDC represented the company's total exports during the reporting period, and not the amount due to TDC assistance.

- On the other hand, an official of another company claimed that the exports it achieved via TDC assistance was two or three times higher than the figure it had reported. According to this official, the company did not want to show too large a volume of exports because of possible tax repercussions.

In these cases, as well as those discussed earlier, it is important to note that the exports being reported by TDC represent not an increase in exports for a given firm, but rather aggregate exports. Baseline data was neither collected nor considered. Hence, we could not determine whether the project objective is being achieved as baseline data was not available. Neither the Mission nor TDC had any record of initial conditions existing at any of the firms from which to measure such increases.[5]

Such baseline data was not collected because the Mission relied instead on unadjusted export data taken from various source documents generally provided by the assisted firms. TDC collects this data on a quarterly basis, but due to differing definitions used by the firms in reporting its exports the end result is not entirely reliable.

We visited ten firms which had reported export sales attributable to TDC efforts. Our interviews with these firms showed that different criteria were being used to determine the export figures to be reported.

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[5] *In October 1993 (two years after the project agreement was signed), the project's technical assistance contractor performed a baseline survey to establish the conditions existing at the start of their contract work. Although this survey of 36 firms contained some information (e.g., total sales, total exports, total production, etc.) which could be used as baseline data for some firms, to date this information has not been used.*

- One company, which reported over $2 million in exports, said that there is no accurate way to determine the amount of their exports attributable to TDC since most of their customers contact them directly. They therefore reported a judgmental percentage of their total exports based on the number of trade fairs they attended with TDC, versus the total number they attended on their own. The company provided no other documentation to support the export figures.

- The chairman of another company which reported $7 million in exports said it is sometimes difficult to decide if a given sale is due to TDC. For instance, entry into a new market through a TDC contact may generate further sales in the same market. This company included such subsequent sales in its export totals attributed to the project.

- We also noted that in some of the documentation provided as support for the reported exports, firms indicated that figures they were reporting were estimates: e.g., "total amount of sales...was approximately 70,000 US Dollars," and "we estimate the increase of our sales volume made through TDC [is]...$100,000." Such comments indicate to us that methods being used to compile and report export data varied considerably from one firm to another.

Without baseline data from which to measure project progress and without clear guidance to the firms assisted as to how data on exports are to be compiled and reported, USAID/Egypt is unable to evaluate in a consistent and reliable fashion whether a firm's exports are due to TDC assistance. As a result, it is difficult for the Mission to effectively monitor the project's performance. Establishing baseline data for assisted companies and providing guidance on how export data should be compiled, documented and reported should help the Mission ensure that such data represent a bona fide increase in exports—and that data are reliable.

The Mission generally agreed with the audit finding, observing that apparently "neither the audit team, TDC, [nor the] technical assistance contractor...appear able to obtain consistently reliable export information at the firm level." The Mission therefore suggested that perhaps the indicator itself needs to be changed, and pointed out that project documentation had anticipated that project indicators might in fact require revision. In addition, the Mission pointed out that the audit was timely in that it came just before a scheduled project evaluation—and that its findings would be used in developing an evaluation scope of work to possibly recommend one or more alternative performance indicators so as to determine necessary baseline data or provide a methodology for doing so.

The auditors agreed they could provide to the evaluators data compiled by the audit on exports generated to date. We also agreed to change the recommendation to recognize the possibility of the Mission's developing an alternative indicator to measure project progress.

2. Small Enterprise Credit

USAID/Egypt monitored this project's activities adequately to ensure that planned outputs and objectives of the Small Enterprise Credit project were being achieved, except that it did not monitor progress toward one key output indicator.

With regard to planned outputs, as of October 1994 the project had established, as planned, 13 loan offices in Greater Cairo in association with the National Bank for Development (NBD), and had achieved a loan default rate of less than 1.5 percent, another output target. In addition, the project has the objective of providing $40 million in loans to 38,000 small entrepreneurs in Greater Cairo and Upper Egypt by the end of the project in 1997. Per Mission records as of March 1995, the project had already assisted about 22,000 enterprises in Greater Cairo with loans valued at over $27 million. In fact, a financial audit conducted by our office verified that as of October 31, 1994, over 29,000 loans totaling about $22 million (some were multiple loans to a single enterprise) had been disbursed.

However, even though the project was on track as far as achieving almost all of its planned outputs and objectives, USAID/Egypt still needs to measure whether the loan program has become financially self-sufficient.

USAID/Egypt should define and measure
<u>the "financial self-sufficiency" of the loan program</u>

USAID guidance requires that project targets be stated in precise and objectively verifiable terms. USAID/Egypt did not meet this requirement for one of the output targets under the Small Enterprise Credit Project. Although the target itself was explicitly stated in the project paper, namely that the loan program be financially self-sufficient "within 24 months," "self-sufficiency" was not defined in a precise and objectively verifiable way. Mission officials stated that they did not measure self-sufficiency because they considered a break-even analysis done by the project's technical assistance contractor to be an adequate measure of the financial capability of the loan program (achieving "operational break-even" being still another target). Consequently, as of March 1995, 21 months after the first loan was made, neither the Mission nor the recipient has reported on progress towards self-sufficiency, and it is difficult to say whether the program is in fact self-sufficient. We believe this output measurement is important in deciding when and how the project's 12 additional loan offices are to be established in Upper Egypt, an area distant from the 13 offices currently operating in Greater Cairo.

Recommendation No 2: We recommend that USAID/Egypt establish a precise and objectively verifiable definition for the target of attaining "financial self-sufficiency" and assess progress made under the project toward achieving the target.

Discussion

USAID Handbook 3 guidance requires that targets for a project be stated in precise and objectively verifiable terms. Meeting this requirement is important in that it enables the Mission to monitor and measure the performance of a project in achieving its planned outputs and objectives.

USAID/Egypt did not meet this requirement for one of the output targets under the Small Enterprise Credit project. The output target of establishing a "self-sufficient" loan program within 24 months after making the first loan was stated in the logical framework of the project paper and in Mission project implementation documents. However, this target, to measure the financial capacity of the National Bank for Development's (NBD) loan program, was not defined in objectively verifiable terms. This makes it difficult to measure the progress of the program in moving towards self-sufficiency. As of March 31, 1995, 21 months after the first loan was made, the Mission should have been able to judge whether the loan program was on its way to self-sufficiency. The audit found that neither the Mission nor the recipient had reported whether this target was being achieved. We noted that this target was retained in a project paper amendment (which was signed in July 1994 to expand the project to Upper Egypt), though again not clearly defined.

Mission officials said that they did not measure self-sufficiency because they considered a break-even analysis done by the project's technical assistance contractor to be an adequate measure of the financial capacity of the NBD loan program (achieving "operational break-even" being still another project target). Some argued that the concept of self-sufficiency was misleading and preferred instead to use the break-even analysis to provide a measurement of financial capacity.

With regard to attaining "operational break-even" the program started to break even—per calculations done by the project's technical assistance contractor—in October 1994. Such calculations were easily done because project documentation indicated how "operational break-even" should be calculated, with precise definitions of "operating income" and "operating expenses," and what costs should and should not be considered. Loan program self-sufficiency, however, was not defined at all.

Although defining targets in precise and objectively verifiable terms is important in monitoring progress, it is also important in enabling decision makers to judge what future steps a project should take. For example, the proposed expansion of the project to Upper

Egypt will add $16 million in grant funds, and 12 more loan offices to the 13 already existing. Being able to assess the financial self-sufficiency of the loan program as it now exists will enable the Mission to judge just how it should proceed with the expansion to Upper Egypt, an area faraway from the 13 offices currently operating in Greater Cairo.

It is our contention that the calculation of "operational break-even" as defined in project documents does not serve as a replacement for a financial self-sufficiency calculation. Notably, certain classes of expenditures such as depreciation and training have been largely excluded from the break-even calculation. We believe, that a precise definition of financial self-sufficiency would include some of these costs, and even perhaps costs for certain services currently being provided by the project's technical assistance contractor. The Mission pointed out that the break-even measurement already includes some training costs and that it would be unreasonable to include all project start-up costs in a self-sufficiency calculation as "worldwide experience indicates that private financial institutions would never participate in...[a] lending program without some outside sponsor contributing [to such] start-up costs." However, we believe that such a calculation—even if it does not include sponsor start-up costs—would provide a better measurement of the financial capacity of the loan program and its ability to expand to Upper Egypt.

In response to the finding the Mission noted that it has recently been attempting to use and build on break-even measurements "to project estimates of progress toward achieving financial self-sufficiency"—although the Mission stated that it believes that the target of reaching self-sufficiency within 24 months is too ambitious a target. Moreover, the Mission stated that it does not believe it is reasonable to expect that a lending program for small entrepreneurs would reach full financial self-sufficiency even within the life of the project, although the Mission added that it nevertheless viewed this target as a vital indicator. Accordingly, the Mission was planning to first revise the project's logical framework and the target, and to define and then assess the progress being made toward achieving financial self-sufficiency in the project's loan program.

3. Technical Support for Sector Policy Reform

The Mission adequately monitored this project, in part due to its association with the high-profile Sector Policy Reform program. However, we were unable to fully answer the audit question on whether planned outputs and objectives were being achieved, because USAID/Egypt had not established explicit outputs and objectives for this $10 million project. The Technical Support project did not establish specific outputs—other than that USAID would provide 43 person-years of technical assistance and would set up a "monitoring unit." In addition, the objective (or "purpose" of the project) was defined in only general terms, namely, to "develop, carry out, monitor, and evaluate" the Sector Policy Reform program—a program designed to give $400 million to the host government in return for its carrying out 41 policy reforms. This lack of explicit outputs and objectives makes it difficult to assess how well the project is performing—and with project funding planned to increase fivefold, establishing specific outputs and objectives becomes even more imperative.

USAID/Egypt should establish explicit targets for the Technical Support project

USAID guidance requires that a project establish at the outset specific, objectively verifiable targets as to what it is to accomplish. The Technical Support project did not do so. The Mission did not establish specific targets for the project because the Mission regarded it not as a "project" per se, but rather as a "source of funds" to support host government reforms. As a result, without defined targets, project implementation seems to be proceeding slowly, technical assistance originally planned may not have been entirely necessary, and monitoring and follow-up was made more difficult. We concluded, therefore, that Technical Support project funds could be more effectively and efficiently spent—and monitored—with the establishment of specific targets.

> **Recommendation No. 3: We recommend that USAID/Egypt establish specific outputs and objectives for its Technical Support for Sector Policy Reform project before any additional funds are approved for that project.**

Discussion

USAID Handbook 3 guidance requires that a project establish at the outset specific objectively verifiable targets as to what it is to accomplish. These targets are to be explicitly spelled out in the project paper and included in a "logical framework" matrix. Establishing such targets, spelling them out in project documentation, and outlining them in a matrix are part of USAID's system of ensuring that planned outputs are met and project objectives achieved. USAID's "Program Performance Information for Strategic Management System" (PRISM), initiated in 1991, also emphasizes the establishment of specific targets.

The Technical Support project did not establish specific objectively verifiable targets for what it was to accomplish. The project paper did not spell out specific targets, either in narrative or in matrix form. Targets for project outputs were described in only the most general terms, and the overall project objective was defined so broadly as to make it difficult to judge whether the project was succeeding or not.

As for outputs, the project was to provide about \$8.6 million in technical assistance to help bring about reforms specified in the Sector Policy Reform (SPR) program—plus \$700,000 to set up and staff a host government unit to monitor the reforms and assess impact. The project paper, however, did not explicitly define the assistance to be provided—nor did it set up specific quantity or time targets for providing the assistance, or for establishing the monitoring unit. The project paper merely estimated that the project, originally planned to last three years, would provide 43 person-years of assistance (mainly eight long-term expatriate advisors) to the host government. Instead of establishing explicit tasks for the advisors, the project paper listed "possible areas" of assistance—few of which were carried out. As for the monitoring unit, the project paper was silent on just how the unit would operate. Detailed guidance on establishing the unit was issued in August 1994—two years after the project paper was signed.

As for the project's objective, this was defined only in very general terms: to "develop, carry out, monitor and evaluate" the project's companion SPR program. Subsequently, this already general objective was expanded. In August 1994, a project implementation letter permitted the monitoring unit to track compliance and monitor impact not only for SPR, but also for "any follow-on program." This expansion of the project purpose, plus a decision to add three years to the project life (even though the original two-year SPR program itself would have long come to an end) allowed still more latitude in how funds were to be used. In other words, the project moved from technical support for the original SPR program, to support for a follow-on program, and ultimately to other activities—notably planning for an umbrella U.S./Egyptian "Partnership" initiative to promote economic growth and development in Egypt. During our visit to the monitoring unit we found that it was already planning for the initiative, even though due to lack of staff, it had not begun its mandated task of assessing the impact of the SPR program.

In summary, the Technical Support project is now to provide support for the original SPR and follow-on programs and for activities to be funded under the Partnership initiative. At the time of the audit the Mission was preparing a project paper supplement to bring all these activities under the project—and to increase funding to $50 million.

Why explicit targets were not established—The Mission did not establish explicit targets for the Technical Support project because, we concluded, the project was regarded not so much as a "project" per se, but rather as a general "source of funds" to support host government policy reforms. Additionally, Mission officials pointed out the difficulty of setting explicit targets for such technical support, since policy reforms required under the SPR program (both the original and follow-on) are definitively established only on a yearly basis. Other Mission officials stated that technical support projects related to policy reform programs require a certain flexibility in order to meet host government needs. Per this view, establishing explicit targets at the outset, and placing them in a matrix, is not possible because of the fluid nature of policy reform.

Why explicit targets are needed—In our view, such targets are needed to better manage a project of this size and complexity. Without targets—and benchmarks for their achievement—such a project could fall prey to a number of problems. In the current case we believe the lack of such targets resulted in the following: (1) the project has been slow in getting started; (2) the technical assistance originally planned may not have been entirely necessary; and (3) without targets and benchmarks, monitoring and follow-up is made more difficult. These points are discussed below.

(1) Overall, the project is proceeding slowly (a 1994 evaluation says the project was "insufficiently exploited"). Virtually none of the long-term technical assistance originally planned was provided (eight long-term expatriate advisors were planned), and two and a half years into what was to be a three-year project, the monitoring unit was only getting started. Another example is the $45,000 earmarked for small grants to academicians: funds for the grants were earmarked in November 1993, but as of April 1995 no grants had been made. It is our belief that targets and benchmarks would have helped move the project along and would have provided technical support in the "expeditious" manner envisioned. This is not to suggest that all the funds should have been spent. Rather, it points out that the lack of targets makes it difficult to assess where the project stands.

(2) The technical assistance planned may not have been entirely necessary: specifically, per Mission records, SPR reforms have largely been achieved with only $3.5 million of the planned $10 million having been spent. We are led to question, therefore, whether all the funds budgeted for technical support were necessary in the first place. Again, without precise output targets it is difficult to assess. Had targets been set in advance, excess funds could have been deobligated—or at least such targets could have been updated or revised in a timely manner.

(3) Without targets and benchmarks, monitoring becomes more difficult—and follow-up on project-funded activities is not assured. For example:

- A $189,000 study funded by the project was to assess the state of market liberalization in Egypt and make recommendations. The study made a number of recommendations, many of which were so general—and without targets or timeframes for their achievement—that it is difficult to determine if they have been carried out. In fact, without established targets and timeframes, it is difficult to ascertain what any given study may have achieved.

- A conference sponsored by the project in July 1994 for individuals from regional policy institutes was to identify and carry out by mid-1995, five research projects: one multicountry research project and four country-specific research projects. However, none of the Mission officials we interviewed during the audit knew what the current status of these research projects was. Apparently because of a decrease in central funding for the institute which set up the conference, the whole activity was reduced in scope and a follow-up conference originally scheduled for mid-1995 to discuss the research was being delayed.

- And finally, the project transferred $2.4 million (the bulk of the funds spent to date) to a technical assistance contract under another Mission project. This contract was to develop a strategy for privatization and to do valuations of state-owned enterprises. However, in our review of this contract in a recent audit,[6] we noted that neither the contract scope of work nor subsequent workplans included numerical targets. As a result, it was difficult to monitor contractor performance.

In response to these points the Mission noted that the $189,000 study had provided the Mission with information necessary to determine if additional policy measures in the area were needed. As for the conference, the Mission asserted that it had received the conference it had paid for and that such a conference was consistent with "developing the Government's sector policy reform program." Also, the Mission indicated that some progress was made as the result of the privatization assistance (Per the Mission, four companies were privatized, 14 were "brought to the point of sale," and four are "privatization candidates for 1995"). We generally agree with the Mission's comments, but still emphasize that having specific targets and benchmarks encourages closer monitoring and better focuses efforts on follow-up.

We concede that not all problems will be solved by setting targets. Targets will not ensure that study recommendations are carried out. Nor will they ensure that provided technical assistance has the desired effect. Establishing targets and benchmarks, however, will serve to focus the project, keep planned activities moving, highlight delays when they occur, and ensure follow-up on results of the activities being funded. We conclude, therefore, that Technical Support project funds could be more effectively and efficiently spent—and monitored—with the establishment of specific targets.

Overall, the Mission agreed with the thrust of this finding that outputs and objectives of the project should be clearer. They noted, however, that the project supports "an unfolding economic policy reform program," and as such it is not always possible to set specific objectives for the distant future. The Mission, however, was prompt in addressing the audit's recommendation in a project paper supplement dated September 1995. The supplement clarifies the project's purpose, establishes priorities for funding project activities, and sets up an "annual plan" process to specify concrete, quantifiable outputs—and benchmark dates for the achievement of these outputs.

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[6] *Audit of the Performance of USAID/Egypt-Financed Technical Assistance Contractors, Regional Inspector General for Audit, Cairo, Egypt, Report No. 6-2163-95-007, April 19, 1995.*

MANAGEMENT COMMENTS AND OUR EVALUATION

The Mission agreed with all three audit recommendations and is currently in various stages of carrying out the actions recommended.

For Recommendation No. 1 (Export Enterprise Development) the Mission has noted that as of November 1995 an evaluation team was already in country, at work on identifying "alternative performance indicators and/or the methodology for collecting...baseline information." Recommendation No. 1 is therefore resolved and will be closed upon our receiving and reviewing the required report from the evaluation team.

For Recommendation No. 2 (Small Enterprise Credit) the Mission will amend the project design to include a self-sufficiency measure and revise the project's logical framework. Recommendation No. 2 is therefore resolved and will be closed upon our review of the amended project design, the revised logical framework, and the Mission's initial assessment of progress being made toward achieving financial self sufficiency.

As for Recommendation No. 3 (Technical Support for Sector Policy Reform), while the Mission agreed with the recommendation, they nevertheless suggested further changes in the report narrative in order to provide more accurate and clear information on the project. The Mission suggested, and we agreed, to delete two points: (1) a point which might have suggested to the reader that the audit would have preferred the Mission to have spent the entire $10 million in support of the original 41 policy reform measures, and (2) a draft report assertion that some project funds were used for activities not directly related to the original SPR program. (On this latter point the Mission contends, and we agree, that the SPR program is in fact broader than its 41 policy reform measures and that these reforms were simply "markers" used to measure progress in that broader program.) We also added information to the report which indicates that several companies had been privatized as a result of project activities. On the other hand, we did not delete from the report the discussion on project follow-up being made more difficult due to a lack of specific targets and benchmarks—although we attempted to clarify this discussion based on Mission comments.

With regard to Recommendation No. 3 itself, the Mission acted expeditiously in approving in September 1995 a project paper supplement to strengthen monitoring of the project. The supplement (which included approval for life of project funding of $50 million) contained a clarified project purpose statement, priorities for management of project resources, and an annual plan mechanism which will identify and quantify concrete outputs–with benchmark dates or timeframes for the achievement of these outputs. Recommendation No. 3 is therefore resolved and can be closed upon our receipt and review of the Project's first annual plan.

SCOPE AND METHODOLOGY

Scope

We conducted our audit of USAID/Egypt's Monitoring of Small Projects in accordance with generally accepted government auditing standards. These standards require auditors to obtain written representations from management when they deem them useful. The Office of the Inspector General deems such representations necessary to support potentially positive findings. USAID/Egypt's Director provided us a management representation letter for the audit that contained essential assertions about the activities we audited. However, USAID/Egypt officials directly responsible for these activities did not provide written representations. As a result, our answers to the audit objectives are qualified to the extent of the effect, if any, of not having such representations.

For the purpose of this audit, a "small project" was defined as any project with obligations of $25 million or less. We judgmentally selected for audit three such small projects: Export Enterprise Development, Small Enterprise Credit, and Technical Support for Sector Policy Reform. Fieldwork took place from January 18 through July 2, 1995. The audit covered project activities from the inception of these projects through June 30, 1995. The audit did not cover host country contributions. As part of our audit, we assessed internal controls in place for monitoring project activities in the two Mission offices managing these projects.

Methodology

Audit Objective No. 1

We determined how USAID/Egypt had spent project funds by reviewing the Mission Accounting and Control System P07C report as of June 30, 1995. We also reviewed various Mission documentation supporting selected expenditures and held discussions with project personnel.

Audit Objective No. 2

To determine what progress had been made, we reviewed semiannual implementation reports, project papers, progress reports, and evaluations. We examined project files for evidence that USAID/Egypt was monitoring to ensure that planned outputs and objectives were being achieved, and we reviewed Mission conformance with Agency guidance on collecting baseline data and on establishing specific, objectively verifiable targets.

For **Export Enterprise Development** we attempted to verify that exports were increasing by reported amounts. To do so, we prepared a schedule from various sources, of exports reported as generated by the project for March 1992 through December 1994. We sorted data by company and date, and traced figures to primary documentation. We selected a judgmental sample of seven firms for additional review which, per our schedule, had each reported exports for the period exceeding $700,000. These seven firms together made up $30.6 million of the $37.1 million of the sales reportedly generated.[1] We conducted interviews at six of these seven companies, as well as at four other firms. In addition we ascertained that certain "outputs" were in place: that promotional materials were prepared as required; that sectoral promotion strategies were prepared and initiated; and that the recipient met targets on numbers of firms assisted.

For **Small Enterprise Credit** we relied heavily on a concurrent financial audit to verify the reliability of certain project achievements (number and value of loans disbursed, etc.). To do this, we compared Mission figures for two objectives and two outputs at September 30, 1994 with audited figures at October 31, 1994. We did not adjust for the one-month timing difference, as audited data merely reflected either a reasonable one-month increase or were essentially the same as what the Mission had reported the month before. In one case we relied on the financial audit's compliance work: interviews with 362 loan recipients to see whether they had met eligibility requirements. With regard to break-even and financial self-sufficiency analyses, we held discussions with project personnel, reviewed project documentation, and analyzed two sets of break-even analyses: one by the contractor and one by the financial auditor. These analyses differed. However, since the amount of operational expenses in the latter analysis may be affected by a finding in the financial audit, we have not commented on the disparity between the two analyses.

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[1] *One of the seven was not a "company" but a foreign broker who reportedly bought $9.6 million in shoes from 13 Egyptian companies. As amounts bought were not broken down by company, we could not verify these figures. We contacted two of these shoe companies. We did not contact the broker.*

For **Technical Support for Sector Policy Reform** we reviewed all completed project activities with commitments of $100,000 or more as of April 5, 1995, examining contractor scopes of work and verifying that contract deliverables were done as required. For the largest project activity, funded (in part) by $2.4 million in funds which were transferred to another USAID project, we relied substantially on work done in a recent audit of 15 technical assistance contractors.[2] We visited the Technical Support project's monitoring unit to judge the extent to which the unit was performing its required duties and discussed with Mission officials plans for expanding the scope of the project. We also reviewed the 41 reforms required by the Sector Policy Reform program and assessed the extent to which project activities were helping carry out that program.

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[2] *Audit of the Performance of USAID/Egypt-Financed Technical Assistance Contractors, Regional Inspector General for Audit, Cairo, Egypt, Report No. 6-263-95-007, April 19, 1995.*

USAID

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

November 14, 1995

MEMORANDUM

TO: Lou Mundy, RIG/A/C

FROM: Shirley Hunter, OD/FM/FA

SUBJECT: Audit of USAID/Egypt's Monitoring of Small Projects - Draft Report dated October, 12, 1995.

Following is the Mission response to the subject draft report

Recommendation No. 1: We recommend that USAID/EGYPT establish baseline data for firms assisted by the project and provide clear guidelines as how data on increases in export are to be compiled, documented and reported or develop an alternative indicator to better measure the increase in exports resulting from the project.

Mission response:

Mission agrees with the recommendation and has included this issue in the scope of work for the Project Evaluation Team, which is about to commence the work. The Scope of work included instructions to the team to identify alternative performance indicators and/or methodology for collecting the baseline information (see attached TI/FI memo dated November 8, 1995 and attachments).

Based on the above, Mission requests resolution of this recommendation. Closure will be requested upon receiving and approving the required report from the Evaluation Team.

106 Kasr El Aini Street
Garden City
Cairo, Egypt

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<u>Recommendation No. 2:</u> **We recommend that USAID/Egypt establish a precise and objectively verifiable definition for the target of attaining "financial self-sufficiency" and assess progress made under the project towards achieving the target.**

<u>Mission Response:</u>

Mission agrees with the recommendation and will amend the SEC Project Design to include a self-sufficiency measure and accordingly revise the PP logical framework (see attached TI/FI memo dated November 9, 1995).

On the other hand, Mission requests that the written comments provided in response to the discussion paper be attached as part of this response.

Based on the above, Mission requests resolution of this recommendation. Closure will be requested upon issuance of the revised logical framework.

<u>Recommendation No. 3:</u> **We recommend that USAID/Egypt establish specific outputs and objectives for its Technical Support for Sector Policy Reform project before any funds are approved for that project.**

<u>Mission Response:</u>

Mission has concurred with the recommendation and has designed and adopted a system to strengthen monitoring in the TSSPR PP Supplement. The PP Supplement was signed by the Mission Director on September 13, 1995.

However, while Mission appreciates the way the audit report provides the Mission's view on a number of issues, Mission believes that further changes in the audit report are still required. These suggested changes, per the attached EAP memo, are necessary to provide more accurate and clear information regarding the project activities and the instances described in the report.

Based on the above, Mission requests closure of this recommendation.

Att: a/s

USAID

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

CAIRO. EGYPT

MEMORANDUM

To: Shirley Hunter, OD/FM/FA

From: Tim O'Connor, TI/EI

Subject: Performance Audit of Small Projects: Draft Report Dated October 12, 1995

Date: November 8, 1995

This memorandum responds to your memorandum of October 15, 1995 regarding the subject audit and in particular the one recommendation on the Export Enterprise Development Project (EED Proj. No. 263-0226).

RIG/A has recommended that USAID/Egypt establish baseline data for the firms assisted by the Trade Development Center (TDC) or, if reliable baseline data cannot be compiled, to develop an alternative indicator. As discussed in the exit conference project management generally agreed with the finding and noted that we were in the process of undertaking an evaluation of the project and in addition developing design recommendations for Phase II of the project. In this regard, we noted in the SOW for the evaluation team that RIG/A had identified this as an issue in their discussion paper and we instructed the evaluation team to identify alternative performance indicators and/or the methodology for collecting the baseline information (Attachment A, Annex A of the signed PIO/T SOW is attached to this memo -- see page 1 paragraph 3).

The evaluation team is in country and working on this issue at this very moment. The evaluation should be completed in February. We believe that project management has taken all of the necessary steps to address this recommendation and that on the basis of these actions this recommendation should be closed.

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Garden City
Cairo. Egypt

MEMORANDUM

DATE: November 09, 1995

TO: Shirley Hunter, OD/FM/FA

FROM: Timothy Hamman, TI/FI

Subject: Draft Report on the Audit of USAID/Egypt's Monitoring of Small Projects

This is in response to your Memorandum dated October 15, 1995, regarding the Small Enterprise Credit segment (Recommendation No. 2) of the above-mentioned subject.

The Mission concurs with the Audit Recommendation No. 2 as revised. However, the Mission's response to the Discussion Paper is to be included in the Audit Report, as an Appendix for clarity. The Mission will amend the SEC Project design to include a self-sufficiency measure and accordingly revise the PP logical framework. Therefore, the Audit Recommendation No. 2 should be closed upon issuance of the revised logical framework.

Audit of USAID/Egypt's Monitoring of Small Projects

Small Enterprise Credit Project

Mission comments on the Discussion Paper

I. The Recommendation Statement:

The Mission suggests Audit Recommendation No. 2 be revised to read:

> We recommend that USAID/Egypt establish a precise and objectively verifiable definition for the target of attaining "financial self-sufficiency" and assess the progress made under the project towards achieving the targets established.

The original wording of the RIG/A recommendation appears to require USAID/Egypt to make a final project determination regarding the financial self-sufficiency of the implementing entity. Such an action would only be appropriate if the project were already fully implemented. Since the project still has approximately two years of implementation remaining, an intermediate report on this issue would appear to be a more effective.

II. The Audit Report Discussion:

A. Reaching Financial Self-Sufficiency within the LOP

The Mission believes that the audit report discussion should be revised to indicate that reaching financial self-sufficiency within the LOP is too ambitious a target.

USAID experience indicates that reaching full financial self-sufficiency within the LOP is overly ambitious for an SME lending project. Our review of the project paper documents indicates that the objective of the project was to achieve a first (albeit critical) level of financial self-sufficiency (i.e., recovery of the direct operational costs associated with lending to X number of SMEs). Accordingly, the Mission has concluded that the statement in the PP logical framework indicating that the lending program would reach self-sufficiency within 24 months is incorrect. The Mission will take the appropriate actions to revise the logical framework.

B. Setting a target for financial self-sufficiency

While the Mission doesn't believe it is reasonable to expect that an SME lending program will reach full financial self-sufficiency within the LOP, the Mission does continue to view this target as a vital project goal level indicator.

In reaching financial self-sufficiency, however, the Mission maintains that a breakeven analysis serves as an important measure of profitability from a banking perspective (for a commercial bank that desires to market a new product) and as such also serves as an important indicator of progress towards reaching financial self-sustainability.

The project paper indicates that substantial effort and analysis was carried out during the design of the project to develop an indicator that was both reasonable to achieve within the LOP and representative of progress towards overall financial viability. Accordingly, Annex G of the project paper discusses in detail the analysis of a breakeven indicator that was considered to be an important and precise measure of profitability for a commercial bank operation. As such, it also constitutes a major (and precise) indicator of project achievement and an important milestone towards the eventual long term financial viability of the program (i.e., the financial self-sufficiency of the lending program).

Thus the Mission has been attempting to use and build on the established project breakeven measures to project estimates of progress towards achieving financial self-sufficiency (It also should be noted that the breakeven analysis is used as an important tool for encouraging a timely disengagement of USAID funding. Thus requiring the grantee to report on such higher level targets could encourage our counterparts to seek a longer period of USAID funding and support.)

Beginning in the first quarter of 1995 the Mission has been receiving reports from the recipient and the technical advisors that provide expanded breakeven analysis. The reports now include estimated expenditures to cover possible TA and training activities that may be needed to maintain the effectiveness of the lending program in periods and depreciation of equipment that will eventually have to be replaced. In addition, the current reports to the Mission now provide estimates of progress towards reaching total financial self-sufficiency of the lending program under various cost recovery scenarios. The Mission will review these reports and determine if further adjustments are needed.

C. <u>Monitoring Financial Self-Sufficiency</u>

The Mission believes that page 11 of the RIG/A report incorrectly suggests that the breakeven (or the financial self-sufficiency) calculations should include provision for the amortization of the costs related to the establishment of the sublending program institutional structure. Such investments are normally very bulky, one time expenditures that include considerable quantities of fixed assets, TA and training needed to create the infrastructure for the sublending unit. USAID worldwide experience indicates that private financial institutions would never participate in an SME lending program without some outside sponsor contributing the bulk of the financial resources for these start-up costs. Unless replacement or maintenance of critical assets is an issue, amortizing such costs would likely be misleading since (by definition and design) it is unreasonable to expect that these start up costs would ever be incurred more than once by the participating entity.

The audit report discussion should also be revised to indicate that the existing project breakeven measure already includes provision for periodic training and TA activities to provide the support needed to maintain the planned lending levels of the SME program.

USAID

CAIRO, EGYPT

UNITED STATES AGENCY for INTERNATIONAL DEVELOPMENT

November 8, 1995

TO: Robert Bonnaffon, AD/FM

THRU: Paul R. Deuster, AD/EAP

FROM: Robert Wuertz, EAP

RE: **Response to October 12, 1995 TSSPR Audit Draft Report**

Please find attached our written comments on the draft report.

Attachment

106 Kasr El Aini Street
Garden City
Cairo, Egypt

Response to October 15, 1995 Draft Audit Report on TSSPR

Introduction:

The Mission appreciates the way the audit report provides the Mission's views on a number of issues of fact and viewpoint. It also appreciates the efforts of the auditors to change inaccuracies and overstatements in those cases where they were convinced by our efforts that changes were warranted. However, in part due to these changes, the logical flow of the draft audit report is now weak in places. Therefore, while we substantively agree with the recommendation, we are suggesting further changes in the report. We respectfully ask that the current draft language be reviewed and appropriate paragraphs and phrases deleted if they are misleading or do no longer fit into the story.

I. <u>TSSPR's New Activity Selection and Monitoring System</u>

Basically the Mission agrees with the audit recommendation. In fact, based on part on the August 10, 1995, audit discussion paper, the Mission has designed and adopted a system to strengthen monitoring in the TSSPR PP Supplement signed by the Director on September 13, 1995.

The recently approved TSSPR PP Supplement incorporates a detailed and specific monitoring plan which addresses the issues raised by the auditors. We believe it is generally agreed that TSSPR is an unfolding project which supports an evolving economic policy reform program. As such, it is not possible to make specific objectives for future, unspecified activities. The standard and accepted approach in such cases is to set up a mechanism and/or well specified criteria for the selection of project activities, and require that each activity financed by the project set out specific objectives, which are then tracked.

Such a mechanism has been adopted. A complete description of this system can be found in the attached TSSPR PP Supplement. Briefly, the Supplement provides a clear set of priorities which will be used to select activities and a selection mechanism. Specific objectives will be specified for each activity approved. In addition, whenever a major new activity is financed by the project, a framework for monitoring will be developed. The frameworks will be reviewed annually as part of the Mission's "R4" review.

II. Some of the language used is inappropriate and some of arguments used to support the need for targets do not logically follow

While agreeing with the recommendation for additional monitoring, we believe that some of the language is inappropriate. Furthermore, several examples and arguments used in the draft audit report do not logically support the conclusion and should be deleted. Many of the examples cited in the rest of the paper do not contribute to the overall conclusion. These are described below.

A. "Excess"

The report makes an unwarranted remark by characterizing the unexpended funds as "excess" in several places, including in the summary on page 2 and on page 13 (twice). The dictionary defines excess as something which goes "beyond the usual, normal, or lawful limit." The Project Paper provided illustrative estimates of budget requirements which seemed reasonable at the time and still seem reasonable in light the job that needed to be done. Slowness of starting, urgency of assistance which mandated quicker short term assistance over the longer term (which would have used more funds), and the time being too short in the first years to do many desirable activities led to lower than expected utilization of funds. Therefore, we cannot agree to the use of the term "excess" as it has serious derogatory connotations. "Remaining" would be a more accurate choice of words.

We pointed out in our earlier response that this entire discussion of "excess" funding is inappropriate since it might suggest to an outside reader that the audit would have preferred USAID to have spent the entire $10 million in support of 41 measures (which is only part of the Project's purpose). We believe that one of the proper roles of auditors is to ensure the Government funds are appropriately spent. Our slowness in spending funds is not, per se, a fault as might be inferred from this line of argument. Indeed, if only $3.5 million had been originally obligated, it is hard to see how the U.S. Government would have saved a single dollar. In sum, we believe this point should be eliminated; if not eliminated, the word "excess" should be eliminated.

B. Page 15, (2) The technical assistance planned may not have been entirely necessary...

In the early stages of the project, the Mission underestimated how long it would take to get long term assistance on the ground. The result was: (1) funds were not spent as quickly as anticipated, and (2) while the letter of the policy measures was achieved, the reforms could have been deepened and been more effective if technical assistance had been available, i.e. the technical assistance was necessary and desirable to obtain better results. Naturally, it is regrettable that the project did not start more quickly and more was not achieved in the first years, but having a project start slowly is common.

The audit report makes a illogical leap, however, when it states that these problems would have been ameliorated by having targets specified in the project documentation. The Mission is well aware that TSSPR was slow to start. We simply underestimated the difficulties involved in obtaining scopes of work which were acceptable to both USAID and the GOE, the time needed to find and contract for services, and the urgency of needs which dictated going with short term fillers rather than the developing long term assistance. We had working targets of what we were trying to do; however, they were not specified in the project paper. Having targets in the PP would not have speeded the process.

C. Page 15, (3) "Some funds were used for activities which do not directly related to the original SPR program"

The audit report appears to criticize USAID/Cairo for funding activities which were "outside" the 41 measures in the original SPR. However, the 41 measures were always simply markers to measuring progress in a broader program. The purpose of TSSPR is to "help *develop, carry out, monitor* and *evaluate* the Government's sector policy reform program" which is broader than the 41 measures. Moreover, when TSSPR was extended by three years, the 7/12/94 Action Memo signed by the Mission Director states that "it was decided in the 1994 Spring portfolio review to extend the current PACD in order for the project to assist the GOE in carrying out the policy reforms under the SPR II program." Hence the Mission was following this broader agenda in implementing TSSPR. In brief, this point is misleading as TSSPR was authorized to fund activities which were not directly related to the original 41 measures of the SPR program. We did not fund anything inconsistent with the purpose of the project. All our activities were and are consistent with the purpose of the project.

The text in the audit report provides two bullet examples of activities funded which are outside of the 41 measures. As we will demonstrate below, each of these activities was relevant to the TSSPR purpose: "*develop, carry out, monitor* and *evaluate* the Government's Sector Policy Reform Program" and therefore it was appropriate to fund these activities under TSSPR.

* The first activity cited in the audit report was a conference on policy reform funded in conjunction with the World Bank. It contained two parts. The first part was to *evaluate* how far the Government's policy reforms had advanced its policy framework. This, to us, is an excellent

way of helping us to *monitor* and *evaluate* the Government's sector policy reform program. The second part of the conference devoted itself to laying out an agenda of future actions. Areas covered in the conference included trade liberalization, the role of the private sector, regulatory reform, the tax system and the financial system. The SPR deals with each of these areas, and the conference helped the GOE better understand what is needed for reform in these areas, and provided us with information we will use in *developing* future policy measures.

* The project earmarked $45,000 in project funds for small grants. According to the priorities for selecting and implementing projects which is documented in the TSSPR amendment (and which EAP has informally followed in the past), this is a low priority activity and therefore it was not implemented earlier. EAP has now received proposals which, if successfully carried out, will certainly help us *evaluate* the impact of the Government's sector policy reform program. For example, one proposal attempts to *evaluate* the actual and potential impact of the trade policy and customs reforms on employment in the manufacturing sector, which is clearly part of the SPR and GOE Sector Reform Programs.

The proposals may also help us *develop* new policy measures. For example, one study proposes to study the effect of pollutants on the population of specific geographic areas in order to suggest policy and institutional reforms which would improve economic productivity in those areas. If successfully carried out, this study would help us *develop* new policy measures for the protection of the environment, which is one of the four areas in which the SPR contains policy measures.

D. Bullets Inconsistent with point, Page 16, (4)

Next, the audit report makes the point that "Without targets and benchmarks, monitoring becomes more difficult and follow-up on project-funded activities is not assured." We quite agree with this statement. Underneath this point, however, are three bullets that do not seem to us to support the statement.

* The first bullet says that "A $189,000 study funded by the project was to assess the state of market liberalization in Egypt and make recommendations. The study made a number of recommendations, many of which were so general - and without targets or timeframes for achievement - that it is difficult to determine if they have been carried out. In fact, without established targets and timeframes, it is difficult to ascertain what any given study may have achieved."

Though this argument sounds plausible, close examination reveals that it does not follow logically. Is the audit report saying that this study did not have a timeframe for completion and a scope of work which defined the required tasks? (It did, and it is included in the PIO/T.) Is the report criticizing the Scope of Work as being inadequate? If so, it should criticize the PIO/T process at the Mission, not TSSPR. Or, is the audit report saying that the study should be faulted because it did not cause its recommendations to be carried out? (What study ever does? Studies make recommendations, they do not normally carry out recommendations.)

The Mission believes it has ample justification for this study which it has presented in its earlier comments. We would be happy to amplify those comments if it were helpful.

* The report also criticized TSSPR for transferring funds to another Mission contract which specializes in privatization and which also did not have numerical targets. It is the strong belief of the Mission that the slow progress of the privatization project is completely unrelated to whether or not the scope of work or subsequent work plans contained numerical targets.

The audit report also contained the statement, "As of October 1994, per the official who oversaw the contract, only one enterprise evaluated under the contract was privatized." We spoke with the Project Manager, and he did not remember making this statement and believes that the statement is not correct. Please find attached a memo on this point.

The statement claiming that only one enterprise evaluated under the contract was privatized is not correct as shown in the attached memo. The contract evaluated public sector companies to bring them to the point of sale in order to privatize them at a later stage. Note that evaluation is an essential step for privatization. With the help of TSSPR funds, four of those companies were privatized, fourteen were brought to the point of sale, and four are privatization candidates for 1995. All these companies are counted in SPR privatization measures for 1992/93, 1993/94, and 1994/95.

In sum, the Mission suggests that the auditor's point 4 be deleted.

Conclusion:

In conclusion, while we appreciate the efforts of the auditors to improve the audit report and while we fundamentally agree with and have already implemented the recommendation, we would appreciate serious review of our comments and appropriate adjustments to the draft report. Thank you.